THE

MORTGAGE BANK

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A STUDY IN INVESTMENT BANKING

BY

JOSEPH L. COHEN

M A (CANTAB)

ASSISTED BY

ALICE RING, Ph D.

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PREFACE

THERE are fashions in economic taste, and any one who writes on one of the prevailing popular topics need not want for an audience There are, it is true, also a few standard lines, and here there is greater difficulty in winning a hearing There is competition of producers for the attention of the limited number of readers For some subjects there is no audience at all and very little chance of finding one They have been branded as dull or insignificant decades ago, and that attitude has remained even when conditions have changed and they have grown important It is customary to relegate the mortgage bank and the mortgage bond to footnotes, the charitable might concede them an appendix, the generous may allow them a chapter in a work on modern banking But many will say that it is putting a strain on charity and patience to ask for a hearing for a whole book, albeit a moderate sized one

And yet the subject has become of such importance in recent years that a study on it may well be thought to have become an urgent necessity Before the war mortgage banks were highly developed in some countries, rudimentary in others, and non-existent in the remainder In the last decade there has been a great out-cropping of them in almost all parts of the world There is a real movement afoot for the extension and perfection of this branch of investment banking Nor is it confined merely to Europe The same tendencies are seen elsewhere The fluidity of ideas in the banking world, the close relation between various markets, and the mobility of capital have brought about parallel developments in different continents

The great growth in mortgage credit which is so significant a feature in present-day social organization is due to two factors to the striking alterations in the wealth and status of

former groups of property holders, and other transformations brought about by the War—and to the eagerness for a more rapid exploitation of resources The subject merits attention on account of its own importance, but it may also claim separate treatment because of the new interest in that branch of banking which deals with the direction and the flow of capital Numerous changes have occurred recently in the organization of long term credit facilities The development of mortgage banking is an effect of those changes and is producing others No sound theory of banking as a whole can be worked out which ignores it

It is proposed in this study to give a brief, but comprehensive, account of the mortgage bond as an investment and of the mortgage bond market, to direct interest to this special form of financing all types of real estate credit with a view to deciding what are its advantages and disadvantages Its scope is thus limited to a small part of the capital market It is, perhaps, the first attempt yet made to examine the questions involved primarily from the angle of the lender, and not, as is usual in discussing real estate credit, from the borrower's viewpoint It is, however, impossible to deal with the mortgage bond as an investment without inquiring into the security behind it, and this involves an examination of the nature and organization of the mortgage bank This point is dealt with briefly, and only so far as is necessary for elucidating the main subject

The growth of the use of the mortgage bond since the War, and, above all, the change whereby instead of remaining a purely local concern, a security interesting only a restricted district, it has become marketable internationally, are tendencies which are of great, though as yet not sufficiently recognized, importance Agriculture in Canada or coffee-growing in Brazil may be financed by London, cotton in Egypt by Paris, a new residential quarter in Budapest or in Buenos Ayres by New York or Amsterdam But these tendencies are as yet in their infancy The merits of this type of investment are not properly appreciated in many countries, whilst in some

they are considerably under-valued This is due to a reason which may soon disappear The market in this type of security is narrow The organization is not yet properly developed With better machinery it will be possible to finance the development of real estate undertakings at a lower rate, whilst investments in them will become even more attractive

Although American writers have recently devoted some attention to this subject, there is no comprehensive detailed study on it in the English language Indeed, in the article on "Bonds" in the *Encyclopaedia of the Social Sciences*, published in 1930, an American writer does not deem it necessary to refer specifically to mortgage bonds It is doubtful whether any such study exists in any language The numerous German publications which seem to deal with it are of the nature of juridic and historic studies, none stress the wide economic aspects Moreover, they rarely show any knowledge of what other countries are doing in this field

The temptation has been strong to discuss two contentious problems closely related to the subject treated, but it has been resolutely resisted There is a growing literature dealing with the question at which stage in the trade cycle it is desirable to buy and to sell bonds, and a much smaller amount of discussion of the question whether, say for the next few decades, we are to expect a rising or a falling rate of interest These subjects are sufficiently important in themselves to be treated independently and not as footnotes to a brief institutional study This publication will have justified itself if it stimulates someone to attempt a larger work

Thanks for information is due amongst others to Messrs Lazard Frères of Paris, Messrs Schroder of London, Mr. Proehl of Amsterdam, the Dresdner Bank, Berlin, the Swiss Bank Corporation, London, and to the Financial Committee of the League of Nations Gratitude is due also to Dr E Wolfgang of Frankfurt, to Professor T H Gray of Washington, and to H D Dickinson, M A, for valuable suggestions

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CHAPTER I

REAL ESTATE BORROWING AND LENDING

A MARKET is a district, world wide or local, in which many buyers and many sellers are keenly on the alert to deal in a given commodity at the best price to themselves The place of buyers and sellers is taken in the capital market by owners and users of capital bargaining for the price of its use This market divides into two sections the one in which business undertakers seek people to share with them in the risk of extending existing businesses or in starting new ones, the other in which persons seek to borrow and to lend capital at a fixed rate for long periods The former is known as the stock or industrial share market, whilst the latter, the bond market, is concerned with the raising of loans for industrial undertakings, for Government schemes, and for real estate development

Real estate in its various forms has always been an attractive type of property, in mediaeval times because few others were available and social and political privileges were based upon it, in modern times because it still confers prestige and satisfies the desire for display ownership But apart from this, its economic significance even to-day is of supreme importance as the source of food and raw materials and the site for dwelling and business activities Probably half of the total value

of fixed capital in the modern world is still embodied in one or another of its varied forms agricultural, business, and house property

Agricultural credits, the oldest and still probably the most important type of real estate credit, are loans secured on farm properties Under modern conditions such loans are required for the purchase of land, for its irrigation and equipment, for the construction of farm buildings, houses and cottages, for fencing and roads

A technical revolution in agriculture is proceeding Agricultural science and engineering are bringing about improvements in production which must have a profound effect on the world distribution of capital and labour The chief task of a rational policy to-day is to induce the millions of farmers to put into practice, as soon as possible, the new technique discovered by science With the adoption of scientific manures, efficient machinery, more economic methods, and the industrialization of certain branches of farming, output can be doubled or even trebled over large areas When we observe how backward the most progressive countries are in exploiting the discoveries of agricultural chemistry, in installing proper drainage, in adopting afforestation schemes, it is evident that colossal capital resources will be required to facilitate the great changes which are still desirable in the more backward countries [1]

Of course, the introduction of proper manures and up-to-date machinery by a farmer would, as a rule, be met out of his own capital or from short term loans [2]

In recent times the effects of war in impoverishing landlords, in making them desire to sell or borrow on their estates, and in making others wish to cultivate a plot of land which they can buy only if they are granted a loan, have been much

[1] A frequent reason for requiring loans on property arises when a testator leaves his estate to his children, only one of whom could or would farm it The others are then satisfied with money compensation, which the inheritor of the land endeavours to raise by way of a loan

[2] In the distressed European countries there is now a demand for an organized machinery for granting intermediate loans for these purposes

in evidence The same effects are, indeed, characteristic of all wars The big landowners of Silesia, for example, were particularly needy borrowers subsequently to the Seven Years War The peasants required money to buy their emancipation and a plot of land Similarly, after the Great War, the "Green Revolution" in the east of Europe, where large estates have been redistributed in favour of the peasantry in Russia, Rumania, Serbia, and Hungary within the last decade, has given rise to a great demand for loans for the construction of buildings, for machinery, tools, etc The broad result of this transformation is a desire to purchase real estate on the part of many of those who did not in the past possess any, and a consequent need of loans to enable them to do so These changes have focused attention on and have greatly influenced the character of land as a form of investment Where capital is absent, it is clearly realized that farming will be impoverished or forced down to a lower level of economic efficiency than might otherwise be attained [1]

Credits are required also for urban real estate The growth of towns and the consequent need for houses, factories, warehouses, wharves, garages, hotels, and theatres create a heavy demand for capital [2] It is sometimes forgotten that the

[1] The agrarian crisis which is at present taking place has as its chief features (1) a transition of consumption from cereal to live stock in industrial countries, (2) an increase in wheat production, (3) heavily falling prices, which producers resist by agreeing to controlled, i e monopolistic prices in their own interests, (4) to monetary *malaise*, and a rise in the long term rate of interest compared with pre-war levels Cf Chapter VII

[2] President A E Dickinson, of the Indian Limestone Co, states that a million new houses are needed annually in the United States to offset obsolescence, destructive fires, and inroads of business in residential sections In a number of European countries housing legislation frequently has deterred private investment unless subsidies were granted Government direct building has often been undertaken

The shrewd business man finds that during a period of rising prices and in places of growing site values, it pays him to take a loan Let us take a concrete instance Say a man with a capital of £1,000 bought a property in 1896 for £3,000, on which he borrowed £2,000 If he bought wisely in a growing area he was likely to find that his property had doubled in value by 1920, i e it was worth £6,000 He is now actually worth £4,000 (This is not the place to argue that the real value of the £2,000 which he owes is now less than that which he borrowed)

industrial town is a comparatively recent growth, whilst the cost of building operations in expanding communities calls for large resources Certain individuals at one time undertook the task of building houses and business premises and sub-letting them at a rental But to an ever-growing extent house occupiers in certain countries and business men in most refuse to be tenants The latter desire to gain from the normal growth in site values in urban areas through their own skill in developing those sites

In European countries, the comparative cessation of building during the War and the first years after the War, in part owing to the high rate of interest on capital, has resulted in an increased need for building now, whilst in the growing new countries the demand for capital for their purposes is enormous Not only is the value of land in and near large and growing towns rising, but considerable increases in value are taking place of whole new areas partly because of actual development, and partly in anticipation of future growth This is seen in the fast developing countries bordering on the Pacific Ocean [1]

A feature common to all forms of real estate, to agricultural, housing, and business property, is then that capital can be used in them advantageously, and that they require long period credits But in this they do not differ from industrial and commercial undertakings Then why should they not be financed as other forms of economic activity requiring such facilities? Business enterprise is, as a rule, undertaken on the joint-stock limited liability principle Funds are raised by public subscription, by capitalizing the future, or by borrowing on estimated earning power Facilities are thus available for the accumulation of large sums for any exploitable undertaking which is properly sponsored

[1] The desire to share in this growing prosperity attracts the speculative investor in land purchase and creates special problems for institutes which grant loans on property All investments tend to appreciate with industrial progress, but the comparative fixity of the supply of land—especially of urban land—makes it a source of much more unearned increment than industrial property It is a source of economic rent—a true surplus

Why then was it necessary for real estate credit to develop a special technique and special machinery in order to make the savings of the community accessible for these purposes? Why was it essential to develop the device of the mortgage bond instead of obtaining capital on the joint-stock limited liability company principle?

The typical unit of production, the average-sized farm, is still comparatively small Even more important is the fact that it is still, as a rule, owned and run by one man In this respect, the farmer is to-day in the same position as was the small independent business man before the advantages of large scale business and limited liability were known The farm in practically all parts of the world depends upon the finance and the administration of a business man with limited means The bonanza farms of America and Russia are hardly an exception since these giant farms are not yet out of the experimental stage The small property owner of to-day is in a similar position to the farmer He can borrow only on the security of his tangible assets He must pledge his land or buildings, stocks or crops, as cover for a loan This is the position also of the man who wishes to borrow on the security of his residential property [1]

Before it was possible by means of a special device to achieve for real estate undertakings what the joint-stock limited liability device accomplishes for other forms of business enterprise, three conditions had to be satisfied an adequate system of creating and registering mortgages, experience indicating under what circumstances property can be relied upon to give an adequate yield, and the machinery for making the security based upon it marketable

What precisely is meant by the term "mortgage"? It is the name of a security given by a debtor in the form of a charge on the property which remains in his possession, the claim to a certain sum by the creditor, if not repaid before

[1] The large office and apartment houses constitute a special type of property, and the problem of using them as a basis for security will be best considered in relation to American conditions (Chapter XI)

the stipulated date, is to be met by execution on the real estate The exact legal and economic nature of this concept varies in different countries It depends on the system of registering real estate, of regulating mortgages, and on the nature of the rights of the mortgage in cases of default

The grant of mortgages on freehold property is widely practised It is less commonly accepted that the device of leasehold mortgage is sound Indeed, it is hardly known in many countries The view that ownership of land has many advantages over leasehold has been supported by many doubtful assumptions and arguments The assumptions that the owner has, as a rule, complete unencumbered ownership, and that the leaseholder always suffers from a rapacious landlord, are of doubtful validity The freeholder has frequently ownership subjected to a mortgage, whilst the leaseholder may enjoy a very considerable measure of security

Under a leasehold[1] the sole owner of the land is the landlord, but the lessee has the right of use as a tenant as long as he pays his rent A lease under which the use of land or buildings is granted for a definite number of years generally contains a number of covenants to be performed by the lessee Protection is given to agricultural lessees in respect of fixtures and unexhausted improvements

The economic nature of a lease may vary a great deal In the case of an ordinary building lease the lessee reaps the benefit of all improvements and increases in value during the currency of his lease, and on its extinction the owner enters into the possession of his land and of a valuable addition to it In the case of a short-dated lease at rack rent the property remains almost unaltered, and the landlord's gain consists in the rent In the case of a mining lease minerals are taken away by the lessee, who must generally pay a fixed rent and, in addition, a royalty proportional to the output One must inquire very closely into the terms and conditions governing

[1] A lease may be regarded as a sale of land for a limited period As Maine points out, "there is no incorrectness in speaking of the letting and hiring of land as a sale for a period of time with the price spread over that period "

a lease to discover the rights and responsibilities of the tenant under it.

Great Britain is known to be the country where the landlord tenant system has been most popular. It is not, however, sufficiently realized that this method of land holding has won considerable support in other countries. This may be seen at a glance from the following table[1]:—

LEASEHOLD TENURE IN VARIOUS COUNTRIES

Country	Year	Leasehold Farms as Percentage of Total Number of Farms	Leased Area as Percentage of Total Area under Cultivation
Great Britain	1916	89.0	87.8
Belgium	1895	78.9	51.0
	1910		54.2
Japan	1921	69.4	46.3
Germany	1907	57.1	13.9
U.S.A.	1920	46.8	36.8
Holland	1921	44.0	48.0
Uruguay	1916	44.0	39.4
France	1892	25.41	47.22
Austria	1902	25.3	
Australia	1922		49.9
Sweden	1913–20	27.7	

Fully one-half of real estate property in these countries is held on lease.

Mortgages may be effected in Great Britain on leasehold as well as on freehold property. The mortgage value of a freehold farm is almost the same as a leasehold farm. Thus analysing the three main elements—the land, the buildings, the yield—we have the following results. The value of a freehold property for which a rental of £100 is obtained works out roughly at 5 per cent at £2,000. The value of a 50-year leasehold interest in this same property amounts to £1,820. Certainly, the value of the buildings on freehold and leasehold property will also show a similar difference in magnitude. The returns on leased land differ in no way from those on freehold land. As a rule, the lessee is given security of tenure and rights

[1] Woytinsky, *Die Welt in Zahlen*, Book III.

to compensation for improvements, so that he is encouraged to obtain the maximum output from his farm

The very nature of the mortgage has misled some into a misunderstanding of the security behind it Attention is generally directed to the value of the property in case realization is unavoidable But the main condition for granting a loan is the ability of the debtor to pay his way and his obligations, including interest and amortization on the loan Now since the value of the land as a pledge is determined by the income which the settler derives, it frequently results that leasehold will be preferred to a freehold property The leaseholder, it is true, is less likely to want to saddle himself with a mortgage precisely because he does not purchase the land But if he desires it he can obtain a mortgage as easily as the freeholder And the mortgage value of property is calculated in a similar manner in both cases In deciding the market value of any property a number of factors are considered, of which the yearly net profit is the most important, and the value of the land, of the buildings, and of other fixtures is of considerable significance The capitalized net return is obtained by multiplying it by the average rate of interest of mortgages

Leasehold tenure has a number of advantages compared with full ownership The lessee is free to devote all his capital to the cost of stock and equipment, together with his maintenance until the harvest Thus he can begin work with about one-third to two-thirds of the capital required for the outright purchase of the land and buildings and fixtures Moreover, the leaseholder is more often in a position to offer a first mortgage for a building loan, whilst the freeholder, who very frequently has already taken a mortgage to purchase the property, can offer only a second mortgage

Leasehold property is not regarded, as a rule, with favour as a security The rental paid is a first claim against it Unless the lessor joins the lessee in executing the mortgage the leaseholder can offer only, what is in fact, a second mortgage Moreover, the lessee, as a rule, agrees to pay not merely the rental but also all taxes and other charges—growing burdens

in modern society The lessee's interest is not increased in proportion to the increasing value of the land, since it is restricted to a certain limited period There are also certain practical difficulties which operate against this form of security It is difficult to value exactly, and legislation in its attempt to safeguard the interests of the mortgagor puts obstacles in the way of the leaseholder

Varieties of mortgage law exist in all countries Special provisions have been laid down to make clear the rights of the different parties and to establish a speedy procedure for their enforcement Legislation was proved by experience to be necessary if a proper mortgage credit system was to be developed One of the chief abuses to be guarded against is the mortgaging of the same piece of property a number of times without disclosing the fact of previous mortgage to the later lenders In Germany a real estate register, a Grundbuch, was instituted for this purpose The importance of the Grundbuch lies in the fact that it registers the property relationship and the debt burden of every piece of land It is open to every interested person An entry in the register is accepted as a valid statement as to the fact of ownership or claims against any parcel of real estate, i e it constitutes constructive notice to all interested, and it embodies the principle of priority over all other rights entered at a later date Although it was once subject to varying local regulations, uniform requirements for the entire Reich now exist

Most Central European countries have developed a complete machinery for registering mortgages in a Grundbuch—a land Register, which is based on these two principles Clearly, to achieve its object the Register must be very detailed with reference to the holding of land, its ownership, and the claims of third parties Every parcel of land in the country is described—its parish, precise situation, its boundaries and exact measurements are given, as well as the net revenues as determined by the government assessors It has its topographic number The name of the owner, the manner in which he acquired the land from the previous owner are entered The rights of third

parties, such as mortgage rights and rights of customary usage, etc, are also noted In many places mortgages are not effective unless registered Disputes have thus been lessened and people are prevented from obtaining credit on property which is already pledged In France and the other countries, whose land law is based on Roman Law, mortgages are subject to "inscription," i e they must be registered There is also a transfer book and the cadastral survey first undertaken in France in 1790 The cadastre embodies in a public register the quantity, value, condition, and ownership of the real property of a country The transfer book contains an account of changes of ownership, and the inscription book an account of mortgages The French system differs from the Grundbuch in so far as it gives only a statement of mortgage indebtedness, and not the details of all the charges and legal commitments attaching to it Furthermore, certain types of mortgages need not be registered The inscription book is therefore not complete This necessitates special investigation by those interested in mortgage credit

Laws requiring the registration of all titles to land have worked well in new countries, and where complete cadastral surveys have been carried through But in England where titles are already complicated, Acts permitting or requiring registration have been resisted and have, therefore, not been as successful A new attempt is now being made in certain parts of the country to have deeds relating to land purchase registered In the event of the mortgagor not complying with the conditions of the mortgage the creditor may, with an Order from the Court, but without having to take a special action, foreclose the property, i e unless the mortgage deed contains some stipulations to the contrary, sell the property, or have a receiver of the rents and profits appointed, or he may enter into possession, and he may also enforce the debtor's personal liability to pay the mortgage debt In the customary transaction, the mortgagor borrows money from the mortgagee and creates a charge on the property as security The charge is not operative, of course, if at the appointed time the mortgagor

repays the loan, and, on the other hand, gives the right to commence foreclosure proceedings if the repayment is not made Another characteristic of the first mortgage is that it provides a preferential right on a specific property The mortgagees of a property or the trustee on their behalf will have prior rights to it than other creditors These features of "mortgage" are to be found only where a comprehensive system of mortgage legislation has been adopted But this is not always the case In Holland, for example, a mortgage has the characteristics of an ordinary contract, and it creates no special obligations and confers no preferential rights

Experience taught that it was safest to grant loans only on property yielding a constant and certain return, the amount of loan being limited to a half or at most to three-quarters of the value of the property But security and yield are not the only desiderata in a modern investment It must also be marketable There were a series of stages before the simple loans on mortgage became a marketable security Gradually the mortgage bond was evolved, and this became a world-wide counter

Before tracing the course of this evolution, let us inquire into the evils and complaints which arose during the period when there was no organized market, not even of a primitive type, for providing capital for real estate Small borrowers were known to involve themselves with moneylenders, and undertook to pay abnormally high rates for loans If they defaulted in payment there were soon dispossessed of their property Even in the United States before special facilities were developed, the farmer was frequently obliged to pay an effective rate of over 10 per cent, whilst in backward countries 15 and 20 per cent have been common This state of affairs still applies in a number of countries The man who wishes to borrow on his town property was in a somewhat similar position It is true that landlords and traders everywhere play a considerable *rôle* in helping certain farmers with credit, but the former are being increasingly eliminated and the latter provide only short term capital Nor have the banks been able to deal with the problem adequately Bankers were,

therefore, often charged with lack of sympathy for the farmer and an unduly rigid procedure This was so even in Great Britain, where a recent committee discovered that some £25,000,000 were lent to farmers by the banks It is doubtful whether within the existing banking system more could have been done The graver criticism lies elsewhere The loans granted by banks were not really very cheap to the borrower, even when nominally at low rates of interest, because granted for short periods only The risk of non-renewal was so great that to avoid it the borrower would often be willing to pay a higher rate of interest The usual conflict between borrowers who are eager for long time credit and the banker who is willing to lend for a limited short time inevitably arose Even where the latter is satisfied that the security is sound he will tell his client that it is not the business of a bank to lend on mortgage He must not lock up his money He is holding the funds of depositors, and must always be ready to meet considerable demands at short notice Fortunately between these two extremes, between the willing but grasping money-lender and the unhelpful banker, there grew up more satisfactory alternatives

What are the chief characteristics of the usual methods of obtaining these credits? The difficulties of direct dealing between the lender and the borrower are enormous How are the would-be borrower and the would-be lender to meet? What is the likelihood of the period of the loan which is satisfactory to one being convenient also to the other? How arrive at the rate of interest? Since personal estimates of character are involved, what is to happen if one party to the contract dies? How arrange if either party desires to bring the businesss to an end before the period originally agreed upon? But even if these difficulties were overcome, the mortgage once effected lacked liquidity, since it was very difficult to transfer it to some other lender It was expensive to bring into being, and it was very costly—practically impossible—to change its ownership

In Great Britain and in other countries, the system of disposing of investable capital on the advice of and through

solicitors became entrenched precisely because the direct method was impossible Nor was this method altogether satisfactory The procedure was apparently simple, but actually very complex As likely as not, the solicitor did not specialize in this type of work and had no adequate machinery for dealing with it He therefore went in search amongst his clients, friends, or acquaintances for someone to lend the necessary sum It would, indeed, be a rare coincidence if he could find a lender of the required amount without much ado It was more likely that if a client wanted a mortgage of, say, £2,000 on his house or farm for 40 years, the solicitor might have to find two or three lenders to join in making the loan Then there might be difficulties about the period of the loan, and negotiations would have to be undertaken to shorten it All this involved considerable expense In recent years this primitive device has been greatly improved The solicitors of Great Britain have formed a special organization, a sort of clearing-house where they meet one another A register is kept in which clients desiring to borrow or lend on mortgage are entered, and frequently their wishes can be quickly satisfied

A more elaborate organization for providing capital for real estate purposes began to grow up at an early date This provided for co-operative borrowing through groups who sought the aid of banks, insurance companies, and mortgage companies on their joint liability, and later these developed into a more elaborate market of borrowers and lenders which included specialized banks This phase was only possible where the citizens of the country to which the borrowers belonged were in a position to lend the necessary capital These various methods of providing this form of credit should not be regarded as necessarily following one another chronologically In some countries all these methods sprang up at about the same time, and continue to function side by side to-day

Of course, as the insurance companies, saving societies, building societies, and investment trusts grew richer and more powerful and were able to provide loans on mortgage, the

individual borrower or his solicitor had his task greatly facilitated And, indeed, the existence of these wealthy organizations offered a partial solution to the problem involved during the decades immediately preceding the war Savings banks and insurance companies were glad to have this type of long time security always available They did not need to trouble about them until maturity The savings banks prefer to have the bulk of their investments in long term securities such as bonds and mortgages, and insurance companies also hold a very high percentage of them Both are more concerned about the security and the yield they can obtain than about the liquidity of their resources Depositors in savings banks are not, as a rule, allowed by law to make heavy and unexpected withdrawals, whilst insurance companies can determine in advance what portion of their assets should be in liquid form, and how the maturities of their investments should be arranged, or they even pay maturing obligations out of the newly-collected premiums In recent years American insurance companies have invested more in real estate mortgages than in any other single type of security In 1925 over 41 per cent was invested in this way It should be noted, incidentally, that both savings banks and insurance companies have a certain advantage in granting mortgages where they are dealing with their own depositors or clients They know something about their reliability and about their resources

The special safety of real estate mortgage investment has long been officially recognized Many States such as Massachusetts and New York permit savings banks to invest as much as 70 per cent of their deposits in first mortgage on improved real estate located within the State and not exceeding 60 per cent of its value Insurance companies, too, are allowed to invest a substantial portion of their funds in such mortgages Many States regard these investments as proper for trust funds Under normal conditions and with proper care not only is the principal safe, but the income is secure It will be no surprise, therefore, to learn that it was customary for considerable English funds to be invested in American

mortgages until recent years But the mortgagee of property on a large scale cannot sit still and merely collect interest and principal as they fall due He must see to it that depreciation is properly dealt with, that taxes are duly paid, and that adequate insurance on the property is met This may necessitate the examination of title deeds and other documents An eye must be kept on property values in the given locality, and this may involve periodical, perhaps annual, appraisal charges In any case borrowers will occasionally become insolvent, and it may be unwise at that time to force a sale of property It will be desirable then to administer it for a time A special organization will be necessary if these activities are to receive proper attention But it is manifest that the individual lender is not in a position to do this whilst the insurance companies and savings banks oppose keeping more than a moderate staff for these purposes

In the U S A the work of the solicitor was often done by local mortgage companies, but they lacked sometimes his reliability and his reputation for conservative judgment. In addition, all the same objections applied to them as to him Yet they had their necessary middleman function, especially when the bigger financial organizations came into being Of course, large insurance and mortgage companies can examine with care the statements of these local mortgage companies They investigate thoroughly all mortgages offered to them, they have machinery for a periodic check on the operation of their agents through re-appraisals, and as they develop, may assume a further and very valuable economic function They may offer to guarantee the prompt payment of principal and interest, to collect the sums due from the borrower, and to see that the contract under the mortgage deed is properly carried out Of course, the value of this guarantee depends upon the size and reputation of the insuring agency If a number of its mortgages are bad its guarantee may in time of need prove valueless, since it is likely to go bankrupt Nor is a small local concern likely to inspire much confidence But a number of large reliable guarantee companies have recently developed

which have gained a high reputation, and mortgages guaranteed by them have a certain amount of liquidity That this type of business has grown enormously in recent years is demonstrated by the fact that in 1928 there were about 1,500 companies in the United States selling guaranteed mortgages or mortgage certificates These mortgage companies represent an intermediate stage between the direct purchase of individual mortgages and the purchase of bonds of a mortgage bank They have the merit of sparing the mortgagee a great deal of administrative work in selecting and supervising mortgages, and at the same time offer him an additional guarantee This has the great advantage of rendering the security more liquid, for it should be noted that although insurance companies and savings banks are not so dependent on holding liquid investments as other financial organizations, they regard them, other things being equal, as an advantage

When a mortgage company which carries out these functions also goes to the public for loans by offering the mortgaged property as security and issues bonds guaranteeing a fixed yield, then it may be said to have gone a stage nearer to becoming a mortgage bank or mortgage institute The one substantial difference that remains is this, the investor is still interested in a specific piece of mortgaged property, whilst the mortgage bondholder has a part interest in a series of different pieces of property

For an ideal form of long term loan there was necessary not merely the mortgage bank, but a special instrument—the mortgage bond It could be employed for securing the necessary long term funds The method of financing through mortgage bonds on a large scale grew up when the mortgage banks discovered that this was the best device for obtaining long period investment by the public But, historically, the mortgage bond came before the mortgage bank, and was issued by a German co-operative association to its members From the inception of this type of bond in Prussia there was a clear conception of the nature of this security, but its development and the founding of banks issuing bonds in other countries

were the result of long experience Certain Dutch companies issued mortgage bonds to finance overseas plantations as early as the seventeenth century These, however, have no connection with the modern development of these bonds which commenced with the activities of the Preussische Landschaft after the Seven Years' War

In return for the capital loaned the bank issues its own bonds, which are, of course, homogeneous and fungible, i e they are exactly alike in value These bonds may be issued in series which will have varying maturity dates and different denominations to suit the requirements of various types of investors They may be issued and sold at home, or they may be issued and sold abroad

A mortgage bond may be defined as a promissory note, repayment on which is due after a long period, secured by a number of mortgages held in trust It is desirable to emphasize the significant distinctions between individual mortgages and mortgage bonds In the case of the former there is a specific security, a specific mortgage on a definite parcel of real estate, on a given piece of land, or on a house or a factory But the individual mortgage bond has, as a rule, no specific security [1] There is a general cover consisting of a large number of claims against undifferentiated pieces of land as well as against any other assets owned by the issuing institute The mortgage is tied to a particular piece of property, whilst the bond is not The holder of a mortgage may, therefore, proceed himself to foreclose the mortgage if the mortgagor is in default The bondholder's rights are customarily exercised through the medium of a trustee As a class, bondholders are secured preferred creditors with property pledged equal to about twice the amount lent Like other classes of debenture-holders they are creditors, and not, like shareholders, partners in a firm The purchaser of a mortgage bond obtains from the

In addition to the general security, sometimes a specific security is added In the United States, however, bonds are frequently issued against a single building The first-class security obtained from investment in a large number of mortgages is sought to be obtained also in this case but by other means (See Chapter XI)

issuing bank a definite rate of dividend and repayment of his principal at a specific price at the expiration of a given period

The mortgage bank has then certain well-established functions both as a lending and as a borrowing organization It must select, appraise, supervise, and administer mortgages, it must collect instalments from mortgagors, it must use its resources in the best manner This requires special knowledge and machinery Similarly, the function of collecting the savings of individuals by inducing them to invest in its bonds called for additional qualities in the management and appropriate devices This aspect grew more important when it was desired to obtain funds in foreign countries

Let us note the procedure adopted when bonds are issued The mortgage bank grants loans out of its own capital on the batch of first mortgages on real estate offered In Denmark, certain institutes issue bonds on second mortgages[1] These mortgages are deposited with trustees, and bonds are issued against them in convenient denominations and maturities in much the same way as they are issued by Governments, and public utility or industrial companies

As the institute exhausts its available funds, in Germany and in the U S A, it goes, as a rule, to the trustee and offers him a group of first mortgages to be used as collateral against a new loan, i e against a new issue of bonds If the trustee in some countries, or the banker himself in others, is satisfied with the diversified parcel of first mortgages owned by the institute and hypothecated with him he accepts them as security for the new issue The public is then invited to subscribe to a properly investigated, well-secured loan In France and in many other countries the mortgage institutes may issue bonds before having acquired the corresponding mortgages But in such cases only a short interval is permitted in which the bonds are not actually covered by mortgages It should be noted that whilst the series of bonds are specially

[1] In Germany second mortgages are sometimes furnished by the "public" mortgage institutes, provided that they are additionally guaranteed by the Provinces This is done also by the Jewish Agricultural and Industrial Aid Society of New York

secured by these specified mortgages, nevertheless they are obligations of the mortgage institute They are secured by its total assets

The mortgage bank, like the ordinary commercial bank, is not an intermediary in the strict sense of that word It is true that it stands between the borrower and the lender, mobilizing a large number of small amounts into a fund and directing it into the channel in which this accumulation should be poured, but it is not a broker The borrowing business is quite separate from the lending business, and the bank has an independent position towards both parties It is not simply a case of the bondholder's capital being lent to the borrowers through the bank Thus there need be no close relation between the period for which the loan is granted and for which the bank borrows, although both are, as a rule, for a similar period

The capital structure of mortgage banks differs from that of commercial banks The latter generally have only one type of security, their capital, but the mortgage banks have two, their capital and the bonds they issue, which, as a rule, is the larger and more important amount But the sums obtained by way of bonds do compare a little with the deposits of the commercial bank, although they are not obtained fairly easily and in certain circumstances almost automatically like the latter Whilst the commercial bank can lend most of its funds only for short periods, since its foremost duty is the satisfaction of its depositors, the mortgage bank is in a position to grant long period loans Custom or law dictates that the former shall maintain certain reserves to liabilities, the percentage ranging, as a rule, between 10 and 20 per cent of totol deposits [1] In a similar manner, custom or law maintains that there shall be ten to twenty times more bonds than capital The business of the mortgage bank has more in

[1] During the year 1928 the average percentage of current accounts to total deposits of the Midland Bank was 55 3, in Germany, for the five largest banks, it was 43 3% The Deutsche Bank has 8 5% of capital and reserves to total assets The Discontogesellschaft has 5%

common with that of the savings bank than with the deposit bank, although the differences too must be noted Like the savings bank it gathers funds from many sources, but, whilst the savings bank collects the small sums of those who open an account, the mortgage bank approaches the capital market The savings bank employs its resources in certain legally authorized securities, in mortgages and Government bonds, whilst the mortgage bank specializes in real estate and communal loans Both make a promise of a fixed rate of return They both work under close governmental supervision

What are the advantages of the mortgage bank and its instrument, the mortgage bond?

The specialized machinery of the mortgage bank enables it to investigate the mortgages offered, the value of the property, the marketability and the credit worthiness of bonds, the issue and redemption provisions It is in a position to know on which property it can safely lend Its distribution of loans on the basis of a great number of mortgages lessens the element of risk Moreover, it is large enough and rich enough to grant mortgages on large estates, on big offices and apartment houses

The mortgage bank, with its collection of well-selected mortgages and the steady income from the heterogenous aggregate of loans it has granted, converts these into a large issue of standardized bonds yielding a fair steady income The first mortgages behind these bonds and the general resources of the bank offer almost certain safety Clearly, such bonds are likely to be and are, in fact, under normal circumstances, readily negotiable They obtain a national and even an international market This has been of special assistance to the countries which lack capital, and where large insurance companies and savings banks were not available The mortgage bank enables the investor to invest his savings in real estate with ease, in a security which requires little supervision on his part The individual mortgage is a matter for the judgment of a specialist But the mortgage bank and the mortgage bond may be judged like ordinary industrial undertakings

or banks—through the published balance sheets, their earnings and dividends, the reputation of their directors, the history of the undertaking The average investor does not go behind these He is, perhaps, ignorant altogether of the true nature of this type of security [1] He can recover his capital at will by selling his bonds on the market without disturbing the borrowers who received loans

The expert knowledge of the mortgage bank, its large scale administration, and its general facilities, enable the borrower to obtain a loan on a sound mortgage in the speediest manner and at the lowest rate So numerous and well appreciated are the advantages of this machinery for financing loans that many local authorities use it for communal loans The fact that it makes capital available at the lowest possible rate is to them its chief achievement It is true that high rates might be borne by agriculture on favourably situated lands But, if a succession of bad crops is sustained the distress of agricultural areas is very serious In the long run agriculture can work successfully only if loans are obtainable at low rates These general considerations are supported by the following ascertained fact The United States Department of Agriculture has estimated that whilst in agriculture the output in any one year is about 25 per cent of the capital invested, in industry it is 100 per cent [2] The interest charged for the loan of capital is, consequently, of exceptional importance in agriculture It is not merely the peculiar psychology of the farmer that has made him so sensitive to the rate of interest

High interest rates have a harmful effect also on house and business property This might be illustrated by reference to the U S A even under the latest conditions where capital for these purposes has been available in considerable amounts Before the Stock Exchange crash of October, 1929, interest rates were high "In the building field indications have

[1] Only an exceptional stock exchange broker is likely to know anything about the different types of organization of mortgage banks, their merits and demerits But the question of marketability is taken up in detail in Chapter IV

[2] *Year Book, U S Department of Agriculture*, 1926

become more pronounced that the high level of money rates and the difficulty of raising funds on real estate bonds and mortgages is seriously checking new projects in many localities Apartment and residential construction has suffered the most marked falling off, while industrial plants and public utility installations which can be financed through stock issues have been least affected [1]

It will be useful to summarize the argument in this chapter

Real estate credit, although part of the general market for credits, is organized by special machinery It is invariably based on the security of first mortgages, which are pledged as a guarantee for the payment of interest and the repayment of capital

Recent economic developments have resulted in an increased demand for credit for these purposes Precisely the same conditions which originally led to the development of mortgage credit in Germany are stimulating its use in many countries to-day For countries poor in capital, eager to hasten their economic growth and to compete with powerful competitors, the use of their land and property as a basis for credit enables them to force their growth Many of the new and more backward countries of Europe anxious to hasten the development of their internal resources which are chiefly agricultural, established or favoured the establishment of mortgage bond institutes Certain Latin American countries have just begun this development [2]

Of the different methods of providing this credit the mortgage bond has obvious advantages, and especially because it is able to satisfy the requirements of lenders as well as the needs of borrowers It is clearly preferable that there should be an organized market where borrowers go for long period

[1] *The Circular of the National City Bank of New York*, October, 1929 It is well known that construction works and the building trades are amongst the first to feel the effects of the high money rates which characterize the boom period (See Chapter VII)

[2] In the richer countries, the U S A and Great Britain, the difficulties of agriculture led to the establishment, with Government aid, of specialized mortgage institutes to serve this industry

mortgage loans with certainty, with little trouble and expense, and at a low rate of interest

Investments in real estate are no longer matters of personal arrangement necessitating detailed personal judgment, they have become part of the organized capital market, and there exists to-day an active interest in certain mortgage bonds in local markets, and some interest in the leading issues in all the money centres of the world

CHAPTER II

TYPES OF MORTGAGE INSTITUTES

AGRICULTURAL and industrial communities are everywhere developing on much the same lines, and the methods of borrowing and lending are broadly very similar Of course, certain national characteristics and peculiarities persist in the financial organization of different countries Thus, the substitution of specifically designed bodies in place of individuals as moneylenders on the security of real estate did not necessarily involve the immediate adoption of the device of the mortgage bond in all countries, nor are these bonds everywhere exactly alike In this chapter it will be our task to analyse the different types of mortgage bond institutes which have been developed, and proceed in later chapters to the examination of the bonds they issue

Mortgage bonds might be issued, it is true, by bodies other than mortgage banks In practice, however, they are generally associated with this special type of bank, or with the mortgage department of a bank carrying on, in addition, credit banking The former are known as pure, and the latter as mixed, mortgage banks [1]

The considerable demand for long term real estate credit, and the recognition that the mortgage bond issuing institute was the method of satisfying it at a reasonable rate of interest, led at a very early date to a demand that governments should encourage its development

In few countries was it found possible or desirable to resist

[1] The mixed mortgage bank, which combines two different types of business—lending on short and lending on long term—is tending to become less usual The advantages seem to be less than the disadvantages In South Germany, where they were once common, no additional mixed banks are to be instituted in the future, although those in existence are allowed to continue The chief mixed banks are the Bayrische Hypotheken und Wechselbank, with capital and reserves of 65 million marks and deposits of 239 millions, the Bayrische Vereinsbank, with capital and reserves of 42 millions and 197 millions deposits

the pressure of the agricultural interests which were the prime movers in the demand for the establishment of such institutes The State, therefore, lent its assistance by issuing special regulations, or by directly controlling the mortgage institutes already in existence in many countries, or by instituting them where none previously existed, whilst a few continued to withhold their support This was due to other banking developments making them unnecessary, or because of the lingering influence of *laisser-faire* ideas [1] Special legal and administrative measures were also taken for ensuring that the banks should be in a position to meet their obligations This supervision has gained support for them since they now inspire commonly confidence

Historical circumstances and political considerations have frequently been important factors in causing the great variations in the mortgage institutes which have grown up They do not constitute a single unified class as is so frequently believed

Mortgage banks may be classified as regulated or unregulated, depending on the attitude of the State towards them The mortgage bond business may be free, i e not subject to special regulations, as in Holland, where any company may issue bonds This type of unregulated issue places the mortgage bond in the category of an ordinary contract It will be interesting to note how far the uncontrolled bank has, in practice, voluntarily assimilated itself to the legally controlled type [2] In most countries, however, the issue of mortgage bonds has been regulated by special law Regulated mortgage banks may enjoy a legal or *de facto* monopoly, the State may confer the right of granting mortgage loans financed by bonds to one institute only, in the same way as it endows the central banks with the exclusive monopoly of issuing notes This has been the policy adopted in France and in Spain Or, the

[1] This is comparable to the attitude of Governments towards savings banks and insurance companies, as well as with merchant shipping and labour legislation Although, like them, opposed in certain countries at an early period, experience has proved them, on the whole, beneficial

[2] See Holland, page 194

regulated banks may be subject to competitive conditions, certain institutes being allowed to issue bonds under specified regulations This method has been adopted in different forms by Germany, and by the U S A for the Federal Farm Loan System Banks

Regulated mortgage institutions may be private joint-stock companies, organized either as pure mortgage banks or as deposit banks with a real estate credit department, working primarily for the benefit of the shareholder, as State banks, concerned equally with the advantage of the investor and with that of the borrower, or as co-operative associations, the latter working exclusively for the benefit of the borrower The joint-stock mortgage banks were the last to be established They based themselves largely on the experience of the early co-operative associations and the later State-administered institutions

The form of organization is not entirely independent of the system of regulation It would seem that the same forces that make for State intervention favour also, as a rule, the development of the co-operative principle and *vice versa* In most countries where the regulated system is in operation, the intervention of the State has not limited itself to laying down regulations for the joint-stock companies and to bringing into existence State banks, but has also made possible and helped to develop co-operative associations, whereas, in countries where a *laisser-faire* policy dominated, private joint-stock companies alone have been developed

A clear distinction should be drawn between State banks owned and operated by a central or local public body, and other forms of direct State intervention The government may guarantee the bonds and grant subsidies to or take part in the administration of co-operative banks and even of joint-stock companies Thus, the Credit Foncier de France, a private joint-stock company, has been endowed with a considerable State subsidy, the government, on the other hand, not merely supervising the bank but taking part in its administration The bonds of another private joint-stock company,

the Mortgage Bank of Cyprus, enjoys a government guarantee The British analogous organization, the Agricultural Mortgage Corporation, has the advantage of a subsidy, and its debentures are recognized as a trustee security

There are clearly a considerable variety of forms and degrees of government regulation, supervision, and intervention The considerable confusion in the literature on this subject arises from the abbreviated expression "State bank," frequently used when some form of intervention only is meant As to the co-operative institutions, Government subsidies are granted to the Hungarian and the Finnish mortgage credit associations, and to the government guaranteed bonds issued by the Danish Land Credit Associations, and by the co-operative Land Mortgage Bank of Warsaw

Let us note briefly some of the main characteristics of the Government, co-operative, and joint-stock mortgage institutes

Government banks in Germany and Denmark, in Spain and Portugal, in the Argentine and in other South American countries, were established previous to the war and provided loans against mortgages On the basis of mortgages, bonds were issued, loans were granted, and the borrowers repaid through their yearly instalments These bonds were then bought up and cancelled Since the war there has been a tendency for the public authorities to intervene more and more in providing rural credits, since the ordinary joint-stock mortgage banks specialize, as a rule, in urban real estate credits The main object of intervention by the Government or by local authorities is to help to raise capital, but they may also aid in reducing the rate of interest in a number of ways

National Government institutes have the advantage of operating over a large area and this tends to eliminate risks Also, both national and local State-owned institutes are concerned with long time considerations They maintain a stable rate in the face of temporary fluctuations These bodies may also enjoy a direct money subsidy, or at least a subsidy in the fact of administrative costs being provided free or at a reduced rate They are guaranteed by the authority in charge of them

The close supervision of these banks by the government gives them an additional security which makes their bonds more attractive to certain types of cautious investors They are frequently used as repositories for the funds of savings banks and of certain government funds, and even given the advantage of being treated as trustee investments Lastly, they are not concerned to show any profit, so that economies may be devoted to reducing the rate of interest By making these bonds secure, by direct and indirect subsidies, and by planning for long periods, they can be issued at a price which gives a relatively low yield If the institute borrows at a cheap rate it is clearly in a position to lend at a low rate But, of course, if any government bank proves by its actions once or twice that it cannot be relied upon to redeem its obligations, then the risk being high it will be able to borrow only at a high rate

The co-operative associations issue mortgage bonds for which the landowners hold themselves jointly and severally liable In their earlier stage, each member was held liable to the total value of his assets for the debts of the co-operative association This was intended to increase their safety Nowadays, his liability is limited, as a rule, to the amount of his own loan, or to that part of it still outstanding, or even to his share in the capital Thus, the liability may be related to his debt as a borrower, or to his holdings as a shareholder

The association being organized for mutual benefit, no profit is meant to be made on the business The interest obtained on the mortgages is only slightly higher than the interest on the bonds, the difference being sufficient to cover the expenses of management and to collect a small surplus as a guarantee fund Such associations were developed first in Germany, Hungary, Sweden, Denmark, and Rumania have followed this model, introducing certain modifications They sometimes obtain State support and are, as a rule, subject to State supervision These associations, together with the State banks, supply the major portion of rural credits

Corresponding to these co-operative associations interested

in rural credits, there are in Germany, Finland, Hungary, and in certain South American countries co-operative associations specializing in the issue of mortgage bonds for real estate in the towns. Their members are entitled to raise loans on mortgaging their city premises. The object, as a rule, is the financing of house building. Sometimes they enjoy a communal guarantee, and even an additional provincial or State guarantee. In such cases these guarantees of security are added to those of the mortgage, the bank resources, and the joint liability of members of the bank.

It is only in the post-war period that the co-operative organization has been extended to the financing of industrial mortgage loans. Joint-stock banks have, as a rule, refused this type of security. The industrial mortgage banks, organized generally as mutual association, subsidized or guaranteed by the public authorities, grant loans on the real estate and sometimes on the general assets of small or middle-sized industrial undertakings. They are to be found in Germany, Finland, and Hungary.

It should be noted that these former types of bank or public institution provided, as a rule, a special advantage to the bondholder. In the case of State banks there is the guarantee of the public body, whilst the co-operative bank offers the additional security resulting from the joint liability of the members.[1]

The private joint-stock mortgage banks, still the predominant type in the urban real estate business, do not offer these additional advantages. As a rule, even when they are subject to far-reaching regulations and supervision, they are not subsidized nor guaranteed by the public authorities, nor do they show any of the other features of co-operative associations. Like other joint-stock companies they have to rely exclusively on their own capital and reserves. On the other hand, these banks can choose more freely to whom and at what rate they

[1] These banks are referred to in Germany as "offentlich-rechtlich," for which public, or publicly recognized, is the best, though inexact translation.

wish to lend, they can be more business-like in their activities, it has been argued, than State or mutual association institutes They are freed from political considerations, and need pay little attention to personal elements of a non-commercial kind

The Credit Foncier de France, founded in 1852, was the first institution formed on the modern basis, i e of a limited liability company issuing debentures for an amount corresponding to the mortgages held by it But the Credit Foncier has qualities which prevent it from being regarded as typical of the joint-stock companies based on its model, the State subsidy, the part taken by the State in its administration, and, above all, the *de facto* monopoly of bond issue place it in a separate category It may, therefore, be preferable to look for the type of joint-stock regulated bank to Germany, or to the U S A Federal Farm Loan System banks, to the Scandinavian countries, the Middle- and East-European countries, to Middle and South America, or to various parts of the British Empire

In Holland, where the unregulated mortgage bank prevails, it does not differ in legal form from any other joint-stock company The regulated banks of other countries show, therefore, special characteristics which the unregulated banks lack In addition to the directors and the actual management, special provision is made for the supervision of the business in order to protect the bondholders In most of the countries a standing committee of auditors or a fiduciary agent is appointed to control the granting of mortgages and the issue of bonds in accordance with the regulations This protection is, of course, not to be found in the Dutch banks

But no matter what type they belong to, the internal organization of the mortgage bond banks depends entirely upon its particular function and, therefore, can be discussed adequately only in connection with the scope of its business

An essential distinction must be drawn between those countries which have established a central bond issuing institute, and those which have a decentralized system Hitherto we

have discussed mortgage banks granting loans to their own customers, which they finance by the issue of their own bonds But another type of arrangement is possible The lending of mortgage loans requires detailed knowledge of the local conditions which a national centralized institute is not likely to have It will, therefore, have to rely on its branches and agencies These may not prove to be as satisfactory as the local banks This is the view commonly held with respect to the centralized Credit Foncier de France, and other countries, therefore, have relied on a more decentralized organization for granting loans The central institution issues the bonds Then it transfers the funds obtained by their sale to the mortgage credit organization affiliated to it which finance mortgage loans These credit organizations either deposit their mortgages as security for the funds which they borrow, or they furnish it with their own bonds based on these mortgages The central institute may be endowed with the exclusive monopoly of bond issue like the Royal Swedish Mortgage Bank, granting loans to the district associations upon the assignation of mortgages, or it may compete with other banks like the Federal Farm Land Banks

This division into a central issuing institute and a decentralized organization of credit-granting bodies proves particularly advantageous when the home market is too weak to provide the necessary funds and the foreign market has to be approached, for clearly the large national organization is better known and held to be more trustworthy

Mortgage banks are used for the financing of city real estate credit because there is a lack of capital, for example, in the impoverished European countries and in some of the new countries obtainable through the customary channels In the U S A , where the joint-stock mortgage banks have of late been very active in this field, it is because of the extreme inconvenience of having hundreds or thousands of joint-stock limited companies approaching the ordinary underwriters to undertake to raise funds on their behalf A group of special underwriters dealing with real estate have crystallized out,

and they, together with the guarantee companies, enable the small mortgage banks to place their bonds on the market [1]

The demand for and supply of capital on real estate has, as we have seen, given rise to a nucleus of specialized institutions, such as banks, specific instruments, bonds, and a class of experienced entrepreneurs But it is clear that whilst the standards to be applied in the purchase of various kinds of bonds, municipal, railroad, and public utility, are familiar to

TABLE OF MAIN TYPES OF MORTGAGE BANK[2]

- Mortgage Banks
  - Regulated
    - Monopolistic
      - *State*
        - Swedish National Mortgage Bank
      - *Joint Stock*
        - Credit Foncier de France
    - Competitive
      - *State*
        - Agricultural Mortgage Bank of Colombia
      - *Co-operative*
        - Credit Association of Landlords in Copenhagen (Rural)
        - Preussische Stadtschaft (Urban)
      - *Joint Stock*
        - Chicago Joint Stock Land Bank of Chicago
        - National Hungarian Industrial Mortgage Institute (Industrial)
  - Unregulated—Competitive—*Joint Stock*, The Overijselsche Hypotekbank

the investor, in a number of important countries the characteristic features of the mortgage bond are still little known Standards or tests need to be suggested whereby to judge mortgage bonds These tests must be continuously valid, although they must be applied to constantly changing situations This fact determines the order to be adopted in the next three chapters which will be somewhat as follows The main characteristics of all mortgage bonds will be briefly analysed under the three heads of security, marketability, and yield The purchaser of any security is concerned to know above all else how safe is his capital, how quickly he can

[1] Cf Chapter XI
[2] An example of each type is given

recover his money for it, if he should be pressed and need it, and what rate of interest will it yield him Before proceeding with this analysis let us summarize the discussion in this chapter in a table giving an example of each of the main types of mortgage bank. (See p 32.)

A further subdivision would be possible between pure and mixed banks Since, however, most mortgage banks are pure this distinction is, nowadays, of little importance

CHAPTER III

SECURITY

GOVERNMENT supervision has largely determined the chief characteristics of the mortgage bond It has had a marked influence on the scope of the business, and on the relation between the bank and the lender, and between the bank and the borrower The security on the basis of which mortgage bonds are issued is very narrowly restricted by custom and law In practice, the business of mortgage banks consists overwhelmingly in the grant of loans on first mortgages of agricultural land, and on house and business property, i e there is a material guarantee for the good faith of the borrower When a customer borrows on personal security there is no safeguard other than his known personal character Again, a loan against title deeds, even when they are left in the banker's hands, may not give him full legal right to dispose of them But a mortgage concedes a legal security of great potency

Besides granting loans on real estate, many mortgage banks have an extensive business of loan granting to municipalities and communes, and to public bodies in general Private joint-stock companies as well as State banks grant these communal credits Co-operative associations established exclusively for financing either agricultural or urban or industrial real estate do not, as a rule, undertake the grant of communal credit along with their other activities The subsidiary function of supplying these credits has in some instances become temporarily even more important than their basic purpose as in France, where the total of mortgage credits outstanding in 1929 amounted to about three thousand million francs, and the total of communal credits outstanding to about five thousand million francs Communal loans are financed either by the issue of distinct communal bonds or through the ordinary bonds The security may be the general credit standing of the

public body or a mortgage on specific land, or certain revenues may be pledged Dwelling-houses and public utility undertakings, such as electricity, gas, and waterworks, are frequently financed by the issue of special communal bonds by villages, towns, counties, or public utility organizations The assumption by mortgage banks of this type of long term loan results from its similarity to the loan on real estate A steady income with which to pay interest and redemption is available The same type of machinery is adaptable for this purpose and, therefore, convenient Clearly, it would be costly for every small local authority to attempt to raise funds by going to the public A swarm of small issues under favourable and unfavourable conditions would be hanging over every large capital centre [1] At a comparatively early stage, therefore, the mortgage banks took up this allied business of granting long term credits to first-class borrowers ready to offer the best type of security In some instances they accept the mortgage of certain forms of transport property, such as local narrow-gauge railways

Mortgage institutes frequently possess funds which they do not require for immediate investment in mortgages They are, therefore, permitted to engage in certain forms of financial activity They may utilize their free funds to acquire and sell existing mortgages, or to buy their own mortgage bonds, which they do very frequently, or they may place them with qualified banks They may buy certain types of listed bills and securities, and even make loans on certain specified securities They may, under conditions which will exclude liability, engage in certain sorts of commission business, such as the purchase and sale of securities for foreign account They are permitted in certain cases to receive deposits to an amount equal to 50 per cent of the paid-in capital of the bank But, as a rule, they are prohibited from encroaching on the functions

[1] We shall see that in Great Britain certain municipalities must have their loans underwritten The occasional innocence of the local representatives makes them an easy prey to sharp underwriters in the City The whole question was raised anew by the Hatry case in 1929 In the U S A municipal loans are not financed by mortgage banks

of the deposit banks or of land dealers They must not, therefore, grant "credits" excepting on mortgage, and they are not permitted to acquire land unless it is necessary to safeguard themselves against loss The scope of their business varies slightly in the different countries

The object sought by way of the governmental regulation and assistance is to enable these bonds to compete with first-class government bonds in respect of security, marketability, and yield Various methods and devices were adopted to this end We shall here consider security first, and then marketability and yield

The measures taken to guarantee security affect, on the one hand, the relations of the issuing institute to the real estate owner, i e they are taken to safeguard the loans granted, and, on the other hand, the relations between the issuing institute and the mortgage bondholder, i e they are taken to induce the potential investor to lend and to make his bond secure

What are the relations between the issuing institute and the landowner who desires to borrow? He is selected with care, his property is investigated, the amount loaned is limited, the mortgage is surrounded with special legal guarantees, and default is dealt with speedily Every device that experience has shown to be useful for making this type of borrowing a sound business has been adopted

Banks are thus obliged to be very strict in the examination of property submitted as collateral for a mortgage, since this constitutes the ultimate security for bondholders They have their own appraisers of property who take a broad view not only of present but of future values These are determined by its earning capacity They examine each piece of property offered in the same way as the individual lender would investigate each individual real estate mortgage, but they have the advantage of special training and wider experience

When appraising property as a security for long term loans, long time considerations must be taken into account Attention must, however, be centred on present market values There is no single way of computing the value of all the

different kinds of real property The science of appraisal, as it is called, cannot be discussed here, although a brief reference to it must be made The chief methods are comparison of sales prices, a separate appraisal of land and buildings, and capitalizing rentals The first method is rough The property appraised is compared with the properties recently sold in the area The second is more elaborate and is, in fact, the most reliable Not only are the prices recently obtained for similarly located land and buildings considered, but also the various items of value that go into constructing the building less depreciation for age, and allowance is made for variations in depth and for corners The third is not very accurate by itself, but is used as a check on one or both of the other methods Even for that purpose it must be refined by allowing for periods of vacancies and costs of administration For statistical purposes agricultural and urban estates are valued on the basis of their rents and the previous prices obtained when a purchase occurred An appreciation of the underlying security of real estate would be obtained from a detailed survey of rent statistics Unfortunately these are, as a rule, unsatisfactory For Great Britain nothing but a brief survey based on fragmentary data is possible

From comments and estimates it is possible to obtain some indication of the variation in agricultural rents in Great Britain In 1790, 10s to 12s an acre appears to have been an ordinary rent, when a rise occurred which continued until 1812, when the average may have been as high as 50s an acre Then began a rapid drop until, in 1830, the average was as low as 20s The tide then turned again, and rents went up steadily until 1879, when the average was about 35s The agricultural collapse in the last quarter of the nineteenth century was seen in a drop of about 30 per cent, and by the close of the century an acre had fallen to 25s During the war there was a great rise, and after 1920 there has been a catastrophic fall, not only in Great Britain, but in the whole world of agriculture These figures must be considered, of course, in relation to the character of the buildings and the

capital sunk by landlord or tenant in the land Moreover, whilst a century ago in England the tenant provided tithe and paid heavy rates and taxes, the landlord now pays the tithe, rates are abolished, whilst the tenant is often free from liability for income tax But even as they stand they show the order of magnitude of rent fluctuations

An interesting comparison can be drawn between these variations in rents and the variations in the general level of prices and of agricultural prices The latter rose up to 260 by 1809 Then general prices fell, but the wars and a period of bad harvests made the price of agricultural products soar General prices fell with certain interruptions until 1849 from 260 to 107, whilst agricultural products fell only until 1830 Bad harvests and the artificial aid of the corn laws prevented a further fall Between 1850 and 1879 the general level of prices rose to 158, at the same time that rents rose Then both general prices and rents declined until 1896, and began to rise before the war Since 1920 prices have fallen from the very high average during the war, nearly three times that of 1913, back to that level In this profound agricultural slump agriculture, the most inelastic industry, has been more severely hit than other industries, and agricultural prices have declined more than the general level of prices

In Germany, too, the three decades between 1840 to 1870 were, on the whole, an era of agricultural prosperity in which the price of products rose and the cost of production decreased During the last quarter of the nineteenth century there was a pronounced agricultural depression as in England, and since the war there has been a similar catastrophic decline of prices.

Rent of land does not fluctuate to the same degree as the general level of prices Moreover, as we have seen, in estimating the value of land attention is paid not only to the rent, but also to the previous purchase price, so that if the rent is relatively high a consideration of previous prices will tend to bring it down, whilst when it is low, the same consideration will tend to raise its value It is not surprising, therefore, to learn that agricultural property is regarded as being, on the

whole, more stable in value than industrial property, and almost as stable as Government securities In making long term rent contracts, an average harvest is contemplated which allows for periods of prosperity and slump to cancel out

Many causes operate to change the value of real estate In the case of agricultural land it is clear that there is a world market for agricultural products, so that the opening out of large new sources of supply in any one country may lower the value of land in other countries The agricultural development of North and South America has had that effect on Europe A war may have great influence in an opposite direction Thus the Great War resulted in an unprecedented European demand for food products from their home growers and from the U S A Prices rose and the value of land in agricultural countries went up With the fall in prices in 1920 an acute crisis developed, and the value of land suffered an enormous decline

Within a country, the construction of railways, the building of ports, an increase in the population all tend to increase the value of agricultural land But the great engineering and biological inventions and discoveries have resulted in such an increase of output that agricultural products have been declining relatively to industrial products Other factors are likely still further to depress agricultural prices The agricultural revolution now proceeding in Russia promises to increase greatly the output of farm products There is also a likelihood that we have nearly reached a maximum population in the western countries With a stationary society on the one hand, and greatly increased output on the other, there is likely to be a fall in prices Moreover, since the amount of new gold available for monetary purposes is likely to fall away from 1932, a general fall in prices is to be anticipated which will further depress agriculture These tendencies may be offset to some extent by the use of agricultural products for industrial purposes [1]

Whether agricultural producers will be impoverished will

[1] *Cf* Appendix

depend not only on what happens to agriculture, but also on what happens at the same time to other prices It will depend on the relative decline of agricultural prices to the general level of prices

In urban property the value is affected by such considerations as influence the rise and decline of whole areas and industries Thus, in Great Britain since the war, the value of property in towns has been rising more in the South than in the North This is due to the extension of certain types of industry Other factors are the increase in the size of population, changes in its character, changes in the means of transportation, and the development of new residential areas There is no evidence yet of any check to the invasion of the towns from the country, so that town property is steadily rising A stationary population and a fall in prices must tend to arrest the value of urban as of agricultural property

The banks require from each prospective borrower an elaborate body of information relating to the property mortgaged In Germany, for example, the following documents are provided An extract from the land register giving full details as to the title and charges of the property to be mortgaged, official plan of site and fire insurance policy, a list of the tenants and a certified copy of the leasehold contracts, a certificate regarding the pre-war rentals of the property, valuation of the property by a certified appraiser, proof of the actual cost of purchase price, plans of the property approved by two surveyors, municipal assessment of property tax, certificate of the value based upon 1913 assessments, certificate regarding post-war valuation, certificate issued by the revalorization office regarding claims filed

Certain types of property are, as a rule, regarded as undesirable security Thus, loans are not permitted on vacant or unproductive land Again, properties which have only a specialized use, like mines, quarries, theatres, mills, factories, are not, as a rule, accepted as security at all or only to the amount for which they could be sold if needed for a different purpose We have noted, however, that certain specialized

banks have in recent years begun to experiment in the grant of loans based exclusively on industrial plants. But they are careful to lend only up to 25 per cent of the value.

Mortgage banks generally restrict their loans to first mortgages. Experience shows that this constitutes, as a rule, a guarantee ensuring that the mortgagor will make good the loan.[1]

Moreover, in many cases the borrower pledges not only his property but also his personal security. He engages his private fortune other than the mortgaged property as additional security for the loan. Sometimes the equity of a life assurance policy is pledged as additional collateral. The larger loans are in every case confined to people of standing.

The law relating to mortgage banks may lay down a definite limit as to the amount of loans to be granted, or may confine itself to certain general principles on the basis of which banks are to work out their internal policy. It is customary to regard about 60 per cent of the appraised value of the property as the maximum, beyond which no loan should be made. In Sweden loans are limited to 50 per cent of the value of the mortgaged property. This is also the limit of the Credit Foncier. In Denmark it is 60 per cent, while in Italy and Belgium the limit is 66⅔ per cent. Since the war mortgages are granted in many countries on an even more conservative basis. In few cases will landowners be able to borrow more than 30 to 40 per cent of the value of the property. The legal limit is, as a rule, a maximum. On vineyards and forests the loan is generally one-third of the value of the property. It is usual to make elaborate inquiry as to the purpose to which the borrower proposes to devote the proceeds of the loan. In some cases borrowing may be due to want of forethought and not to necessity. A loan may, indeed, lead to waste and even to luxury. Certain it is that banks do not merely assume

[1] The purchase of a house by means of a mortgage loan which is to be amortized is a species of instalment buying, the unessential difference being that, as a rule, in the case of the latter the shopkeeper, and in the case of the former the banker, has the right to take the property on which default has been made.

off-hand that all loans will lead to immediate investment in improvement and development

The amortization of loans is frequently required It is usual with agricultural loans, and with respect to city real estate it is generally insisted upon by the co-operative city institutes and other public banks They require, as a rule, that interest and amortization charges shall equal about one-half of the income of the property

Two main methods may be adopted for the extinguishing of a loan instead of payment in full at the end of the period stated The borrower may pay the interest on the full original amount of the loan plus a half per cent or more of the principal per annum—a method adopted by the German Landschaften The part of the extra payment not needed for interest and expenses is put into a sinking fund to redeem the mortgage bonds credited to the mortgagor Since the accumulations to his credit depend upon the earnings of the Landschaften from these sums, it is uncertain when precisely the bonds issued will be redeemed, but they are calculated to be redeemed before a stated date Another method is adopted by the Credit Foncier de France The annuity is determined by the length of the credit, and the agreed rate of interest, and remains the same during the whole period When a payment is made the bank deducts therefrom the interest due to itself, and applies the remainder to reduce the principal of the loan The steady diminution in the principal lessens the amount due in interest so that capital repayment is increased

The operation of the sinking fund is visible evidence that bonds are being redeemed, and that the capital behind them is safe It also guarantees another element of security Suppose that a number of the mortgages will have to be foreclosed Some of these foreclosures may be expected to occur comparatively soon after the mortgage is granted, though this is hardly likely, and some may occur later If then it is assumed that default, when it takes place, occurs on an average when the amortization fund has operated sufficiently long for half the loan to be repaid, then, seeing that the

amount lent is perhaps a third or half the value of the property, it follows that even then the security is actually four or six times the value of the debt

Failure to pay amounts due quickly leads to the taking over of the property by the mortgage institute In Bavaria this may occur immediately upon default In Hungary the waiting period is three days The Credit Foncier may take possession in fifteen days, whilst in America the rule is to give a longer period of grace. Property taken under foreclosure proceedings must be promptly sold But in certain mid-European countries, where this has been undesirable in recent years, arrangements are made to hold and administer it until a propitious market is available [1]

All these provisions for guaranteeing security are regarded as necessary if the main object of mortgage institutes, the provision of long term credits on real property at a low rate, is to be attained But other regulations may also be laid down Thus in some countries the margin between the borrowing rate of the institute from the investing public and the lending rate to real estate owners is specifically limited In the case of the Credit Foncier it is six-tenths of 1 per cent, and of the Italian National Bank forty-five hundredths, in others it is 1 per cent This narrow limit for administrative expenses is intended to stimulate efficiency and economy Another set of measures is taken to guarantee the security of the bondholder

The specific security provided by the mortgages is held by the bank for the bondholder By virtue of the law the mortgages recorded as cover for the bonds are privileged assets primarily securing the claims of the holders of mortgage bonds These claims are entitled to priority over those of the shareholders and other creditors of the mortgage bank

Provision is made to prevent excessive issue of bonds Those outstanding must be covered by mortgage to a like amount yielding at least the same rate of interest If this cover is temporarily insufficient, arrangement is made for a supplementary

[1] Certain cases occurred where considerable profits have been made by those who were obliged to foreclose on the property of mortgagors.

cover of cash or of first-class securities The total volume of the bonds in circulation bears a fixed proportion to the total of the paid-up capital and the reserve funds

In Denmark, the amount of bond issues outstanding is limited to six times the amount of capital stock of the mortgage institute, in Norway it is eight times, in Italy and Sweden ten times In Germany, twenty times the capital and reserves may be issued as mortgage bonds, and of communal bonds and mortgage bonds together, twenty-eight times of the capital As a rule the institute must apply 10 to 20 per cent of its annual earnings to surplus, until this reaches 25 per cent of the capital The sinking fund may be utilized to purchase part of the loan for immediate cancellation or used for bonds drawn by lot, or may be regularly invested and allowed to accumulate at compound interest until the final date of repayment of the loan The investor gains, as a rule, if bonds are purchased or redeemed, preferably the latter, for this tends to keep up their price nearer the figure at which they will be ultimately repaid But, however operated, the sinking fund increases the security of the bonds

The final line of defence is the capital of the mortgage bank together with its reserves These are, of course, invested and lent out on marketable securities that can be sold in an emergency In addition to these elements of security, there are often extensive publicity requirements which go far beyond what is demanded of credit banks and other types of business The detailed balance sheets and annual reports provide a check on the sound working of these institutes

All these regulations are, as it were, the legal and administrative framework into which this business is fitted But they still leave considerable scope for the judgment, initiative, and wisdom of the bank's administrators These still have to decide as to the quality of the mortgagors, the length of the loan, the rate of amortization, when to issue new loans, etc The success they achieve will be reflected in the price at which their securities stand in the Stock Exchange market And it is highly significant that, in the U S A, bonds subject to the

same Government regulations will frequently bear different quotations because they are issued by institutes in which the administration is of a different quality[1] The imposition then of safeguards, the laying down of conditions and regulations, and the continuous State supervision do not diminish the responsibility of the administrators of a bank to endeavour to conduct its affairs profitably On the other hand, the average investor is practically assured that any State supervised mortgage institute is a safe organization to which he can entrust his funds

Much depends in the matter of the security of the bonds issued by a mortgage institute on the distribution of its risks, the nature of the cover whether specific or general, the size of its organization, and ultimately on its capital stock and reserves, or, in the case of associations of borrowers, on the collective liability, limited or unlimited, of members

The mortgage institute is in an admirable position to distribute the securities in a variety of ways First, it may grant hundreds or thousands of loans, the amount involved in any one mortgage being relatively small Thus, in 1927, two of the biggest Germany mortgage banks granted the following loans—

DISTRIBUTION OF LOANS ACCORDING TO SIZE

RM	Mortgage Loans Granted Up to 100,000	200,000	500,000	1,000,000	More than 1,000,000	Total
Bayrische Hypotheken und Wechselbank	261,045,688 (61 440)[1]	36,242,149 (253)[1]	38,607,322 (132)[1]	22,606,622 (31)[1]	36,169 376 (17)[1]	394,678 157 (61,837)[1]
Preussische Centralboden Kredit Anstalt	109,142,243 (10,387)[1]	27,834,693 (190)[1]	35,116,759 (114)[1]	20,641,164 (30[1]	31,991,030 (14)[1]	224,725,889 (10,735)[1]

[1] Number of loans

The Federal Farm joint-stock land banks closed 7,399 loans, totalling $40,571,750, in 1928

The Credit Foncier de France granted 4,334 mortgage loans

[1] In Germany the long tradi ion and experience, as well as the detailed governmental regulation and supervision, has had the effect of tending to equalize the yield of bonds of different mortgage banks,

amounting to 271,000,000 francs, and 2,505 communal loans amounting to 451,000,000 francs in 1928

An illustration will make clearer the nature of the security resulting from the diversification in relation to the capital of the institute Suppose the bonds outstanding amount to 20,000,000 units, it may be dollars or marks, and the loans are restricted to 50 per cent of a conservative appraisal value of mortgaged property Suppose also that the capital and reserves amounted to 2,000,000 units, and each loan to 5,000 There are then 4,000 mortgages A substantial number of defaults would have to occur among the borrowers, and a substantial fall in the value of their mortgages and on the property market, before this capital is entirely dissipated Obviously, a default will rarely involve any loss, and almost never a total loss Even assuming there was, indeed, a total loss, then 400 must occur before the capital of the bank is exhausted An over-appraisal, a mistake in judgment in one or in a few loans is thus a relatively small matter Furthermore, the banks may practise a geographical diversification of risks Different areas are subject to different risks, because of different climatic, financial, and industrial conditions

A third form of distribution is the investment in different kinds of property—residential, office, commercial, and agricultural property Here, also, it may be expected that different influences will affect these different types of property, so that even if one declines in value, the others will retain their value or even increase

But, in practice, this latter type of diversification is seldom to be found Indeed, so considerable are the differences between farm property and urban property, that it is often found convenient to specialize either in one or the other But on the whole, agricultural mortgages are less popular since agricultural land is frequently difficult to sell, and is, for this reason, less desirable as a security than town property

The one advantage which is claimed for the industrial mortgage bank over the other types of mortgage bank is that it can distribute its risks better amongst different types of undertaking

In the impoverished European countries, owing to the lack of capital, the long term needs of industry very often remained unsatisfied or had to be satisfied by means of dear short term money. These facts, aggravated by the long period of depression through which certain industries were passing, emphasized the need for a properly organized system for supplying long term credit to small and middle-sized firms which could not directly approach the market. The machinery of long term real estate credit based on first mortgages was utilized because mortgage bonds were expected to find a ready market in view of their special advantages. Since 1924 a number of such mortgage banks issuing bonds have been specially established for financing industry. These banks, as a rule, are organized as co-operative organizations controlled and guaranteed by the government; their bonds are surrounded with special additional guarantees in order to prevent a dangerous immobilization of capital due to the accumulation of special risks. The three biggest industrial banks whose bonds are quoted on the London and New York Stock Exchanges are the State Mortgage Bank of Saxony, the National Industrial Mortgage Bank of Hungary, and the Industrial Mortgage Bank of Finland. Time will demonstrate whether this type of institute has come to stay, whether businesses offer a sound security like agriculture or urban property. There is little experience as yet to guide us with regard to industrial loans financed through mortgage banks. Is the long term loan against the security of a factory or warehouse a desirable extension of mortgage bank activities? Is it due merely to the present lack of capital in certain countries, or does it satisfy a need which is always present in our economic society?

The answer to these questions cannot be given with complete certainty. But it does seem as if the present banking and Stock Exchange arrangements in England are contrived primarily to satisfy the needs of the very large firms, those with a capital, say, of at least a quarter of a million pounds. Those with a capital of twenty-five thousand to a hundred and twenty-five thousand may, indeed, find great difficulties

in increasing their capital even though they have a sound undertaking The former may appeal to the public, the latter must seek to interest some financier It may be a matter of doubt whether even in a rich country this is always possible, but certainly in poorer countries many sound but small undertakings are kept back through a lack of capital

Assuming then that there is a permanent need for this type of loan, is it a safe type of security? Time alone can really answer that question But it is clear that the risks can be well distributed If a hundred loans are to be given on the basis of the security of the businesses, then these might cover every type of commercial, warehousing, and industrial activity On the other hand, the mortgage bank management will require to have more knowledge of a wider range of affairs—they will have to watch the whole development of industry, they may have to be ready to hold and conduct businesses if their creditors give them up

The mortgage bank must always endeavour to make a right valuation of the property on which loans are requested But this is extremely difficult with whole businesses owing to the constant variations from optimistic to pessimistic views, from boom to slump Depreciation in the value of property alone might be very considerable Thus, as a result of the 1920 troubles when the high prices of farm products collapsed, many farms still carry mortgages based on values that are not likely to be attained for very many years This difficulty is greater even in the case of loans on other types of security In 1920 the big City banks in England and the U S A had millions of loans against inventories which, in some cases, had depreciated by four-fifths, just as in 1929 many lenders on unseasoned collateral in the U S A witnessed a shrinkage of two-thirds of supposed values The fluctuations in the value of businesses being what they are, there is considerable scepticism as to the possibilities of industrial mortgage banking

A recent development has taken place which gives the holder of mortgage bonds a still further protection in the form of a guarantee or an endorsement by a surety company This may

take one of two forms either it guarantees to the legal holder the payment of the certificate and also the payment of interest due on it, or it guarantees the payment of principal and interest when due on each underlying mortgage deposited with the trustee It is significant to note that the guarantee of a surety company involves a check on the type of mortgage taken by the mortgage institute This feature is still peculiar to American conditions because there the urban mortgage companies are, as a rule, comparatively small

An adequate policy of distribution of risks, as well as a satisfactory provision for capital and reserves, is partly dependent upon the size of the institute Mortgage institutes in Europe when working under regulations have, therefore, as a rule, been more or less large scale undertakings, and many American countries, such as Argentina, Chili and Bolivia, have followed this example

The capital stock of the Credit Foncier de France amounts to .	Frs 300,000,000
The capital stock of the Deutsche Rentenbank Kreditanstalt amounts to	Rm 500,000,000
The capital stock of the Swedish Royal Mortgage Bank amounts to .	Kr 30,000,000

In France, Italy, Spain, and Portugal one company with an actual or virtual monopoly is authorized to issue mortgage bonds, and enjoys special privileges granted by the Government

Since the war there has been a general tendency towards larger units, even in Germany where every type of mortgage bank is found But even there not more than some seventy bodies actually issue mortgage bonds The situation in the United States in this respect is very different Apart from the Federal Farm Loan System, thousands of bodies make their own issues Some of these are very small, and this has proved to be a serious disadvantage for the development of real estate credit The fuller discussion of the size of the mortgage institute will come more conveniently under the heading "Marketability"

The principle of undifferentiated security has been adopted

by most countries This means that for purposes of repayment bonds are not based on any particular parcel of mortgages This general cover for the mortgage bond is usual for the issues of the home market Foreign issues, however, are often provided with a special cover Thus, if the general credit situation of the issuing country makes special security desirable, specific mortgages will be assigned for the purpose As in the case of Government bonds, so mortgage bonds with a defined special security may have a higher market price than those with a general security The Rentenbank pledges certain specific mortgages for each issue These specially pledged securities being as they are more easily seen by the investor or his representative are, in fact, regarded as one of the chief reasons for the comparatively high price of these issues Indeed, a discussion has been taking place whether it would not be better to have specific security behind each issue of foreign loans, i e of bonds offered in foreign markets Hungary and Jugoslavia have adopted the same policy of granting special security Closely related to this device is that of the Argentine State Mortgage Bank No specific mortgages are pledged, but a special reserve fund is granted in addition to the security of the general reserve fund for each series issued

Another element of strength lies in the nature of the directorates These include, as a rule, representative leading bankers or, at least, representatives of the chief banks and insurance companies

To what extent are mortgage bonds actually secure? It is evident that a borrower who obtains some 50 per cent of the value of his property is not, in practice, likely to allow it to pass over to the mortgagee if he can prevent it At the same time the mortgage bank, not at all anxious to have the task of dealing with property left to it, will seek as we have seen to limit itself to sound borrowers, and to a cautious appraisal of the value of the property Losses, of course, occur in this as in other fields, but the percentage is small compared to the value of the business transacted Statistics demonstrate to what a small extent the banks are actually obliged to exercise

their right to take over and sell out the property When they do they are generally able to obtain their capital In brief, the measures which are being taken to make these bonds safe are, in fact, highly successful This may be illustrated from the mortgage institutes in the U S A , the Credit Foncier, and some of the German organizations [1]

TWELVE FEDERAL LAND BANKS
(In Dollars)

	1929	
Loans outstanding	$1,202,570,708	
Foreclosures	6,430,133	= 05%

FORTY-NINE JOINT STOCK LAND BANKS
(In Dollars)

	1929	
Loans outstanding	$601,120,669	
Foreclosures	5,134,759	= 83%

The National Association of Real Estate Boards of America states that a questionnaire in 1923 disclosed that, on a total sale of mortgages by the reporting firms since 1900 of $1,119,452,000, and of bonds amounting to $287,546,000, there had been a loss of $38,955, i e 00003 per cent This was, however, offset by 894 foreclosures from which a gross profit of $207,600 was secured

CREDIT FONCIER DE FRANCE
(In Francs)

	1926	1927	1928	
Loans outstanding	—	3,062,698,764	3,157,829,228	
Foreclosures	—	823 203	708 635	= 02%

PREUSSISCHE CENTRAL BODENKREDITANSTALT
(In Marks)

	1926	1927	1928	
Loans outstanding	—	228,186,965		
Foreclosures	—	293,523		= 0 1%
Interest due	—	14,393,456		
Interest not paid	—	309,746		= 2 15%

[1] Whilst in the U S A fluctuations in the value of real estate have a wide amplitude over a fast rising level in most parts of the country, the fluctuations on the Continent have been small round a gradually rising level This has made the mortgage business in U S A relatively insecure compared with European countries

GEMEINSCHAFTSGRUPPE DEUTSCHER HYPOTHEKEN BANKEN

(In Marks)

	1926	1927	1928	
Loans outstanding	383,024,130	—	—	
Foreclosures	322,582	—	—	
Interests not paid	1,606	—	—	= 0 1%

This specific evidence is supported by the well-known fact, that losses on the mortgage investments of insurance companies, building and loan associations, and savings banks have generally been very light

There is thus good justification for mortgage bonds having become almost in all countries a legal investment for saving banks, insurance companies, and frequently even of trustee funds The outstanding features of the mortgage banks, conservatism and resultant safety, are the direct result of the elaborate structure of conditions and regulations on which they do business

CHAPTER IV

MARKETABILITY

The Stock Exchange may be regarded as a place where public auctions are held for the sale of securities It is an organized market for certain standardized rights The securities being in general demand, cognizable and portable, constitute the best type of media for a market Through the sale and purchase of securities, of these standardized rights, the transfer is made of command over capital from those who hold it in a ready form, to those who desire to invest it, as a source of income Mortgage bonds constitute one of the various types of bonds dealt in on the Stock Exchange The development of a public market in them came comparatively late

What are the requisites for an active organized market in mortgage bonds? They must constitute a type of security which is important enough for the Stock Exchange dealers and brokers to find it worth their while to know about them, i e expert advice on them must be available and there must be frequent dealings in them

The desire to make bonds marketable may be seen in the number of methods of their issue, in the policy of market intervention, and in the attempt to enlarge the investing public It may be interesting to trace the history of an issue of mortgage bonds throughout the stages followed from the emission of a new loan based on real estate until its repayment

There are three ways of issuing them · (1) through a syndicate of banks, (2) through the gradual issue by the mortgage institute itself, and (3) through the issue of scrip of the bonds, and not cash to the borrower, which is also done by the bank itself, and does not call for the intervention of other bankers

When a new large issue is brought out on a scale which qualifies it to be regularly quoted and dealt in on the investment market, special efforts are made to get it taken up by

the public The success of the issue depends on three main factors the firm, or firms, which take charge of the issue, the price at which it is issued, and the arrangements made for underwriting it [1] The merchant financiers who constitute the issuing syndicate may be one of the long-established cautious, reliable firms with a large capital of their own, rich in experience and knowledge, with a solid reputation, strong connections, and sound organization, or they may be a comparatively small, poor, new firm The name of these older firms associated with a loan is regarded as a guarantee of the soundness of those launching the new undertaking for which the capital is required, and gives confidence to certain types of experienced investors [2] Often enough, the name of some new little known syndicate indicates that the issue, for quite sufficient reasons, was refused by one of the older firms, and that therefore the new firm cannot be trusted in its attempt to launch the new issue

The price fixed is important, and requires a nice appreciation of the conditions and mood of the market and its probable opinion of the borrower, the syndicate, and all the other circumstances of the loan In fixing the price, the issuing house will be guided by the present price of those securities actually quoted and dealt in on the market which most nearly resemble it It will have to note the price of existing issues made by the borrowing mortgage institute, those of the bonds of other banks of the securities of the Government and, especially, of communal bonds, with all of which the issue will have to compete It will contrive that the price should be slightly cheaper than similar issues, in order to give investors an inducement to absorb the new issue Here a certain difficulty arises from the fact that the same security, if

[1] The charges for underwriting new issues vary from something purely nominal—a fraction of 1%—to substantial amounts of 5% or 10% Higher charges have occurred from time to time, but borrowers who are so reckless are rarely in a position to meet the interest and amortization

[2] In spite of their body of expert investigators, of engineers, accountants, lawyers, etc , they, too, lend their name to undertakings which sometimes fail

quoted in a number of centres, may be three or four points cheaper on one exchange than on another If a quick distribution amongst ultimate investors is desired, it will be wise to issue at a price satisfactory to all markets The issuing houses generally consult with a few leading stockbrokers, stock dealers, and banks, since the two former will be called on to help in disposing of the issue, and the latter may be required to grant credit facilities on them

The issuing house must have a body of underwriters who generally co-operate with it The latter do not desire the issue for themselves, but undertake, and will be called upon, to buy, and perhaps hold for a time, whatever part of the issue remains unsold when it is offered to the public On the other hand, if the public take up the whole issue, the underwriters have nothing to do but to collect their commission for having undertaken the risk If the underwriters are left with a substantial portion of the issue the prices will fall, and may continue to do so until they have disposed of them to those who wish to hold them as an investment Such an eventuality would generally be regarded as highly unfortunate But, in certain circumstances, it may turn out very well When the Agricultural Mortgage Corporation issued its £5,000,000 debenture loan in 1929, the underwriters were left with 85 per cent of the issue, and the price fell to a 3 per cent discount, but within three months their price had risen to over par

The issuing house and the underwriters generally endeavour to dispose of as much as they can to large permanent holders, like insurance companies, investment trusts, certain types of private banks, and big trading businesses The remainder are disposed of through the investment market itself The dealer's advice is followed by many of the general public, whose interest will have been awakened by advertisements in the Press and prospectuses by post The command over the market which the great issuing houses possess undoubtedly enables them to find the necessary funds with the least possible delay and with the minimum of trouble

An alternative to this method of issue by public subscription

through the market is that of gradual sale by the mortgage institute directly over the counter to the investing public The former method has the merit of placing the issue once and for all at a given price, and of thus freeing the institute from any further anxiety about market fluctuations On the other hand, it may have to pay not only for the costs of issuing, but a high rate of interest over a very long period—indeed, a rate which it may itself find difficult afterwards to obtain from its clients This was frequently the case in the Central and East European countries for the decade after the war The second method was therefore resorted to, which enables the institute to adjust the selling price of bonds to actual market conditions at the time of issue, and to fix the price at a rate which gives a certain margin over costs This advantage leads to the view that frequent small issues, however troublesome, may be at certain periods preferable to infrequent large issues

A special form of issue of mortgage bonds is that of handing over to the borrower the scrip and not its cash value This was usual from 1856–1877 (except for an interval of two years) with the Credit Foncier, and was then abandoned The German publicly-recognized co-operative banks have used this method from their institution, and so did the private banks during the inflation period for a short time owing to their lack of capital The same method is adopted by the Banco Hipotecario Nacional of Argentina, where loans are usually made in bonds, as well as by the Caja de Credito Hipotecario, the biggest mortgage bank of Chile

The co-operative associations were obliged by their statutes to give loans to their members who fulfilled certain conditions, and it was this device which enabled them to carry out this undertaking In virtue of script issue there could be no lack of credit, i e of some sort of credit, as long as the mortgage bonds did have a price Moreover, it made the institute independent of market conditions But, clearly, its disadvantages were great Those who borrowed in bonds might lose heavily in disposing of them or, again, might gain The risk of the market remained, but instead of the mortgage institute itself,

the borrowers took it—assuming that they were determined to borrow Few State and co-operative institutes continue to issue bonds to their borrowers to-day

In order that a given issue of bonds shall enjoy a good market, the total amount of the security must be large, it must be listed on the Stock Exchange, and dealings in it must be fairly frequent Otherwise, the prices quoted will be wide and will have little significance Numerous dealings will be less necessary if the issuing house disposes of the bonds to those who propose holding them as investments for long periods The dealers must be in a position to buy from the market, i e other Stock Exchange members, in the aggregate a considerable supply at the price quoted, without having recourse to holders outside the market who might be induced to sell at special prices only On the other hand, the total holdings of the market ought not to be too large, in proportion to the total issue, since it is only the channel through which securities flow to investors [1]

A clear distinction must be drawn between the issue of a new large loan on the security of mortgages and dealings in existing securities The latter are already divided into relatively small parcels and distributed amongst the holders, the investing public, and the dealers in the market If a parcel is offered to the market the dealers buy it with their own capital, or by borrowing money from bankers who lend on the basis of the securities held by the dealer But a new issue is held only with a view to unloading as soon as desirable on the public Whilst the former kind of deal has, as a rule, little effect on the price of securities, the latter may result in a considerable change of price

The operation of a sinking fund narrows the margin between the bid and the demanded price because the market is usually maintained closer to the redemption price The demand for bonds created by the sinking fund is usually sufficient to

[1] In Germany and, indeed, in most countries, dealings on the Stock Exchange constitute a small percentage of the total business carried on in mortgage bonds

absorb most of those that come on to the market More especially soon after it begins to operate, bonds held in weak hands are lifted off the market, thus leaving only those which are held in strong hands, those likely to hold for long periods if not until redemption Sinking fund provisions with a definite date for redemption prevent securities from falling far during periods of rising rates of interest because they are to be redeemed at par, or rising too high during falling rates A special type of sinking fund requires that payments shall be made into the fund for use only when the bonds fall below a certain price In this way the market price of the bonds may be stabilized The investment of the resources of the mortgage bank gives its directors, as a rule, another weapon with which to influence the price

Each mortgage institute makes a market for its own bonds It will stimulate active dealing amongst its friends It will purchase bonds coming on to the market at a relatively low price If the price is tending to rise too high it will sell some bonds There will, frequently, be the purchase of securities out of amortization funds Indeed, most mortgage institutes will have many opportunities of stimulating a real interest or, at least, creating the impression of a lively interest in its securities Even a small mortgage institute in the straitened conditions in which Palestine finds itself creates a small market as a result of the re-purchase of its bonds by the institute which accepts them for interest or amortization [1] Its friends are also induced to buy them

The purpose of this market intervention through buying and selling is (*a*) to avoid irrelevant fluctuations of price and yield which unduly disturb bondholders, (*b*) to carry out changes in the mortgage bank policy, brought about by alterations in the Bank rate, and (*c*) to prepare the market either for new issues or the redemption of their own bonds To prepare the market for a new issue, the existing security is made to stand

[1] The General Mortgage Bank of Palestine was founded in 1923 It has a paid up capital of £50,000, and £86,964 appear in the liabilities as debentures Loans are confined to urban dwellings and never exceed 60% of the value of the building

as near as possible to the price at which the new one is to be issued on the market

The control and the regulation of the price is an acknowledged and recognized function of the mortgage bank In the same way as the representative of the Dresdner Bank, say, will buy from and sell shares to the brokers dealing in the shares of his bank, so will the representative of the mortgage bank All the leading mortgage banks have their own official or their representative at the Stock Exchange This very fact, and the knowledge that they will counter any extensive bull or bear activities, lessens the likelihood that the pure speculator will be tempted to enter this field This intervention in the market by the mortgage institutes is normal, and not exceptional as in the case of ordinary securities It is well known, of course, that it is usual for the issuing house of a *new* security to take the necessary measures for maintaining its price until the issue is not merely allotted, but likely to have arrived in the hands of permanent holders, and only then to create a market If the mortgage bank pegs the price with a proper appreciation of the demand for and supply of liquid capital and the yield of the bond, there can be no objection to the practice Moreover, it has, undoubtedly, been successful in avoiding undue price fluctuations for mortgage bonds In spite of small dealings their price fluctuates less than any other class of bonds Influencing and evening out the rate as a normal practice might be useful In a security in which there are no daily considerable dealings, the throwing on the market of even a comparatively small parcel may have an unduly large influence in lowering the price Or again, a comparatively small demand, above the normal, might unduly raise the price If for any reason the value of any single issue tends to sag and this is not corrected, it may tend to disturb confidence in the other issues An impartial authority fixing the price would, therefore, be very useful for preventing unnecessarily wide fluctuations, whilst at the same time encouraging an active market But the actual representative is not impartial He is anxious always to keep the price of

his bonds as high as possible He manoeuvres and manipulates to achieve this end Where the price is regulated, it is not likely to be kept at the competitive level And, undoubtedly, if a bank is willing to buy up all the bonds which come on the market at a given price, it will be able, at least for a time, to maintain a desired price But its power to do this is extremely limited In the first place, in countries with a competitive mortgage bank system, every month or so some other bank comes on the market with a new issue The rate at which this can be sold depends on the general conditions of demand and supply[1] of capital for that particular type of investment This rate influences, indeed dominates, the older issues Of course, an understanding may be arrived at by the banks concerned not to issue their bonds, say, at over 8 per cent, but then, if the market is not satisfied with that rate, the price of those issued will fall below par If it falls to, say, 88 9, it is yielding a flat 9 per cent In the second place, it must be recalled that a large proportion of the purchases are still made by or on the advice of banks, investment trusts, or other large professional agencies who will not for long allow themselves to be manoeuvred into paying more for bonds than the effective demand and supply would justify Indeed, they are more likely to buy shares where prices are not influenced by interested parties Intervention may defeat its own object of achieving a steady high price

Government securities fluctuate more in their day-to-day price since there is, as a rule, no intervention in their market Mortgage bonds being regulated are more steady, this gives them power to compete They are less influenced by changed bank rate, political events, new issues, etc

Is a period of low money rates a good time in which to issue new bonds (*a*) absolutely, (*b*) in relation to previous issues? Clearly, a period of low money rates is associated with a period of an available supply of floating capital Long term rates will then also tend to decline somewhat This, however, may

[1] Agreements as to the conditions of issue have been reached between German banks

take time The mortgage banks will always seek to make their issues during such periods in order to obtain capital at the lowest possible price The issue of new loans at rates lower than those provided by previous ones will tend to make the market price of these earlier issues rise without in any way involving further charges on the banks, and, therefore, will be regarded as satisfactory by the existing bondholders On the other hand, investors may be reluctant to tie up funds for a long period at an unfavourable interest rate, if they regard the low rates as unlikely to last

At a given moment an equilibrium is reached between long and short term rates If that equilibrium is disturbed so that the short time rate declines, i e so that money becomes cheaper, it will be wise for the mortgage bank to buy up its own bonds for which it is paying a relatively high rate, rather than use its liquid resources on the money market In other words, during a period of relatively low prices for short time money they are wise to buy up their earlier bonds, whereas, they ought to sell as many as possible of their own bonds in their *portefeuille*, when money rates are high Disagio profits of this kind are eagerly sought by mortgage banks

When the long term rate of interest declines and the value of the old issues rise, the disparity between the new conditions in which the bank gives loans and the old rates which they had to pay for their money leads to the necessity for conversion If this is impossible, they will issue new loans at lower rates

The clause preventing redemption before a certain period protects the holder, however, against unduly early repayment of the loan [1] The bank gets rid of the *portefeuille* of its own bonds at a rising price This tends to lessen the rise and thus evens out prices

Very often two bonds, whose risk element is the same, will have a varying yield, of which the only explanation that can

[1] Many German issues during recent years, when Germany had to pay high prices for loans, contained the provision that the borrower had the right to redeem after a comparatively short period *Cf* Appendix III

be found is that one is more readily marketable than the other. In the case of railroads in the United States, as well as of public utilities and of industrials, the fact of bonds being unlisted makes them cheaper. This is indicated in a difference of interest rates of 0.5 to 1 per cent. This is the premium put on marketability, i.e. on the advantage of enjoying a more ready market. Clearly, where there is a reasonable chance that it may be necessary to raise cash at some future time, although no definite date when it will be needed is known, these marketable securities will be sought. Commercial banks confine themselves largely to such issues. The temporary surpluses of big business houses are also invested in them. Even insurance companies, investment trusts, and savings banks carry sufficient marketable securities to provide against emergencies. And seeing that banks will lend considerably more on marketable securities than they will on those lacking such a market, they will be sought by business men.

The test of marketability is the narrowness of the spread for a quick sale. Where the spread is very narrow, say $\frac{1}{16}$ or $\frac{1}{32}$ of a point between the bid and asked price, there a security enjoys marketability. This characterizes Liberty bonds and British Government bonds. As a rule, one-quarter or even one-half spread is usual in a marketable security. In the case of inactive securities the spread may be between 1 and 2 points, while in the case of securities which are traded in infrequently, the spread will sometimes be as great as 10 points.

A dealer on the Stock Exchange often offers to buy first-class mortgage bonds at 1 per cent, or even at ½ per cent, less than he offers to sell them at. In the case of other stocks in which sales are more frequent this "turn" is, as we have seen, much finer.

A number of factors influence the width of the margin, the difference between the price at which a dealer is willing to buy, and that at which he will sell. Where there is a large issue of bonds which is constantly coming on to the market and an equally good bond of the same government or bank,

which is a small issue and rarely comes on the market, then the dealers will require a wider margin in the latter case than in the former.[1] Again, the bonds of very small and little known mortgage banks may have a 5 per cent spread or more between buying and selling price. The dealer may have to carry this security for some time before a purchaser is found, and in the meanwhile its value may have declined. There is the other danger against which he tries to guard himself by a wide margin when he undertakes to deliver a mortgage bond which he does not possess, and which does not frequently come on to the market. He may be unable to complete his contract without trouble and expense, and again is liable to some uncertainty as to the price he may ultimately have to pay.

During a dull period or when the market is apprehensive, the margin is likely to be particularly wide.

The following well-known Stock Exchange laws summarize this experience. The larger the market for a security, the smaller generally are the fluctuations in its price. The larger the market for a security, the lower is the percentage turnover on the business which Stock Exchange dealers charge for doing business in it.

We may now examine briefly the actual situation with respect to the marketability of mortgage bonds on local, national, and international markets. But it should be noted that taking the world as a whole, the older methods of borrowing and lending on real estate are still commonly followed outside the market. There is a large body of borrowers seeking capital, and a considerable number willing to lend who do not come on to the market at all. The absence of a well-organized market for mortgage bonds is both the result of, and the cause of, this more primitive trade through private negotiation. This fact must always be kept in mind, since it limits the present scope of the activities of mortgage institutes, and, at the same time, it should stimulate dealers so to improve their market organization that all dealings will be

[1] The stock exchanges of Berlin, Hamburg, and Frankfurt will not quote securities which are issued in less than one million marks.

done directly through it. But even now the market has a considerable influence on outside dealing. Investments in land and house property are, to the lenders, an alternative to investment in a marketable security, and are, therefore, influenced by the yield offered to investors. The standard set by the market is taken into account in fixing outside bargains.

Limited as is the market in mortgage bonds, it is still very considerable in certain countries and has characteristics of its own.

Previous to the war there was an active sale for local mortgage bonds. Banks specialized in those which interested their own investors. Some preferred local securities not only for sentimental reasons, but because they could have a personal knowledge of the undertaking and of those in charge of it, and were able to estimate its prospects. The greater their knowledge, the less the risk. Against these advantages had to be set the disadvantage of poor marketability, but this was not regarded as very serious since they bought to hold.

The risk that an investment in mortgage bonds may mean that the owner cannot recover command over capital, except by a forced sale at a considerable loss, is a more important consideration for certain types of investors who wish to have command of liquid resources, than the fact that its yield is small. They will not buy these local bonds. The purchasers know that in the exceptional case in which they might wish to realize, another person must be found in the locality who, like themselves, wishes to use his special knowledge.

The whole of France was, and is to-day, a market for the bonds issued by the Credit Foncier de France. Similarly, the whole of Sweden invested in bonds of the Central Swedish Mortgage banks. In Germany, the bonds issued by smaller mortgage banks were held by local investors, whilst the bonds issued by the big banks belonged to the leading national investments.

Then there are issues which are bought and sold in two or more investment markets, but not in all. Thus, Amsterdam was a market for some of the best-known German mortgage

bonds, and Switzerland is a market for a number of Balkan and Scandinavian issues Then there are securities which can be dealt with in practically all the major international investment markets There are very few of these They include the bonds of the national mortgage banks of Argentina, Chile, and Colombia, the bonds issued by the Central mortgage banks of the Scandinavian countries, the bonds of the newly-established Finnish and Jugoslavian banks, and the German Rentenbank Kreditanstalt also seem to have been successfully placed on the international market The bonds bought internationally are frequently issued abroad Special attractive qualities are often attached to these "external" bonds

The development of the mortgage bond as an international investment is comparatively new Previous to the war no broad foreign market for this type of security was available, now, for obvious reasons, most of the European countries are anxious to approach foreign markets for loans secured by real estate Naturally, a market for foreign mortgage bonds was first developed in countries with a mortgage bond system of their own, already familiar with this type of security Thus, Amsterdam and Berlin and, to a certain extent, Paris, previous to the war, quoted a number of foreign mortgage loans, and have since then extended their activities in this direction

In Great Britain there is still little knowledge of foreign mortgage bond issues because, until recently, it had nothing comparable with them in its capital market The U S A is now informing itself about this type of security, though its interest is of recent date

The greatest single obstacle to the growth of an active international market in mortgage bonds still remains the lack of knowledge about this form of security In the two great capital centres, London and New York, mortgage bank bond issues are regarded as not very important forms of loan They are not treated as they are everywhere on the Continent, as a particular species of a wide and important genus If

business in mortgage bonds is to be started in these centres a vicious circle must be broken through. Information for the biggest international securities, e.g. for United States Steel, for Canadian Pacific Railways, and even for such new-comers on the market as Kreuger and Toll and Margarin Unie, is at everyone's disposal. For the majority of securities the dealers are looked to for special knowledge. The individual investor, unless he is in an exceptional position for gaining special knowledge, depends on the advice of the stockbroker, who, in turn, is dependent, to a large extent, upon the dealer. But he whose business it is to acquire and to supply information will do so only in respect of securities in which there is likely to be a substantial volume of business. Even if he endeavoured to induce investors to hold securities in mortgage bonds the market would for a time remain small, and it cannot well bring any profit to him so long as it is on a small scale. If once nursed and got going, however, the broker would find that it pays him to have this knowledge, and the scale of dealings would grow. Here, as elsewhere, *l'appétit vient en mangeant*.

Because of this, much of the business in mortgage bonds that ought to come through the organized market does not, in fact, do so, and of the dealing which does take place a large part is over-the-counter dealing. Thus, whilst in the case of industrial, public utility, and other forms of corporate activity it is usual for investment operations to take place through the organized market, in the case of long term real estate investments it still remains exceptional. In a number of countries much of the buying and selling of mortgage bonds is done directly between bank and customer, and a comparatively small quantity of bonds are sold through the Stock Exchange. There is, thus, a great deal of mortgage bond marketing which has very little to do with the Stock Exchange.

It may be worth while to note the situation in a few leading countries.

The most active market in the world for internal mortgage bond issues remain Berlin. The lack of capital has prevented very much investment in foreign issues, but the Germans

are greatly interested in their own, some of which are of international significance (A list of these is given in the Appendix)

The foreign mortgage bonds in which Berlin was interested were those of Hungary, Poland, Denmark, Norway, Sweden, Finland, and Chile After the war dealings in foreign mortgage bonds practically ceased

Broadly speaking, mortgage bonds in the home market are bought by small private investors, whilst those on the foreign market are bought by insurance companies, trust companies, i e by professional investors Previous to the war, the small and middle-class investor and the public corporations bought them, because they were frequently recognized as investments for trustee funds After the war they were bought first as a speculation, and later by big insurance companies, the savings banks, and investment trusts There is now taking place in Germany a rapid resumption of investment by the private investor The widespread confidence in these bonds is shown also by the absolute amount bought on the market, and by the relative preference for this type of bond in contrast with other types of bonds

In the U S A one must distinguish between the Government organized loans and those of private companies Farm loan bonds are free of tax and, consequently, are a favourite with the super-taxpayers They are bought also by professional investors and, recently, foreign investors have grown interested in them Bonds of the private mortgage banks are bought by the general investing community A distinction may be drawn between the large banks, such as the New York Mortgage Company, whose bonds are bought widely, and certain small local banks whose bonds are bought only locally Mortgage bonds have frequently enjoyed such repute that the investor has had a false sense of security, and has, therefore, failed to make the necessary inquiries New York is also interested somewhat in South American and European mortgage bonds Broadly, one may say that there is a widespread confidence in American "real estate" bonds The assets of insurance

companies in the U S A consist almost entirely of securities, and by far the largest percentage of these is in bonds and mortgages In 1925, out of published assets of $11,500,000,000 for all life insurance companies in the U S A , $4,800,000,000, or nearly 42 per cent, was invested in real estate mortgages, and $4,300,000,000, or 37 per cent, in "bonds owned" The next largest item, loans to policyholders, which included loans related to real estate, was about $1,500,000,000, or 13 per cent Thus 92 per cent of their assets were in very conservative types of investment, whilst about a half was based on the mortgage of real estate The savings banks, too, are large lenders on mortgage An increase or decrease of savings deposits therefore greatly influences the amount of building construction, and specially of residential construction The insurance companies and savings banks are frequently restricted in their choice of investments, so that mortgage bonds which are trustee securities are greatly sought [1] This explains why most mortgage banks seek the privilege of having their bonds recognized as trustee security

In Great Britain the insurance companies seek long period investments, and, therefore, marketability is not with them a prerequisite Mortgage bonds, whose markets is limited, invariably sell at a somewhat lower price than equally well secured issues with a ready market Hence they give a somewhat higher yield and are desired by insurance companies They are regarded also as being satisfactory for financial houses and investment trusts for a part of their funds But, broadly speaking, as the coupons upon the bonds are not often payable in London, they are of little interest to the private English investor There is no active market, so that few stockbrokers could give much information about them Moreover, because they are listed under different heads on the Stock Exchange, under governmental, industrial, and banks, their special identity is ignored

[1] In Latin countries, in France, Spain, and the South American Republics (Italy has a mixed system), the trustee has absolute freedom to invest funds as he thinks proper and is not guided by the existence of any Government list

Paris has long been a centre for the issue of Government bonds, and is also engaged in a number of mortgage bonds Particular interest has been taken in Egyptian and South American mortgage banks and their bonds, as well as of all parts of the French Empire

The yields of wholly or partially internationalized securities tend to be equalized by the working of the market, whilst the local securities exhibit wide inequalities of yield depending upon local circumstances International securities are in request in all countries The bonds of the German Rentenbank are held by investors in all parts of the world, like the bonds of the chief governments and of very large public companies, such as those of the Suez Canal and the Canadian Pacific Railway The telegraph tends to keep prices at almost exactly the same level in all the Stock Exchanges If the price drops in New York or in Berlin, the mere news of the drop tends to cause a drop in Amsterdam and in London If for any reason the news is delayed, that particular class of bonds is likely to be offered for sale in the high priced market under telegraphic orders from the other markets Sales and purchases will strengthen the tendency of the price to seek the same level everywhere The arbitragers may be relied upon to see that this is achieved Clearly, the price of large quantities of an international security cannot be higher in one market than in another This demonstrates the fact that there is a world market for capital in which international influences are already strong and are rapidly growing in strength

Such securities thus exercise a powerful influence in tending to equalize the rates of interest obtainable for long time loans on good security throughout the Western World

The larger mortgage loans are, of course, quoted on the leading Stock Exchanges In Berlin, and some of the other Exchanges, they are so well established that there is little difficulty in any investor obtaining information or in purchasing real estate securities But, on the New York Stock Exchange it is different The new real estate companies found it difficult to obtain the attention they deserved It was

decided, therefore, to institute an Exchange specializing in real estate securities The constitution, trading rules, listing requirements, and jurisdiction over members and their accounts are modelled on those of the New York Stock Exchange Through its members, investors in any part of the country may buy and sell securities on the trading floor of the Exchange with a sense that unsound securities or securities issued by irresponsible organizations have been eliminated as far as possible The listing requirements provide that an application must be accompanied by a report of qualified appraisers on the actual valuation of the property The financial condition must be explained with regard to mortgages and other forms of indebtedness The Committee on listing must be satisfied with new issues They have power also to suspend dealing in listed securities, or to direct that any security be removed from the list

The four main purposes of the New York Real Estate Securities Exchange[1] are to facilitate negotiation, sale, and transfer of stocks, bonds, and other securities based on real estate, and the financing of real estate, to provide a regular place for trading in real estate securities under proper rules of business conduct, to investigate securities offered for listing, accepting only those which pass the tests of rigid appraisal and other requirements, to maintain high standards for dealing in real estate securities by establishing membership based on firm business character and reputation

The avowed object of the Exchange is not only to protect the investor, but to provide a market. These securities, because of their lack of marketability, were regarded as non-liquid, or as frozen, assets Sales were difficult to effect, and, consequently, it was hard to borrow on this class of securities Less capital flowed into this field in consequence The steady development of this market will be watched by European countries with great interest, although their need for such special facilities is not so great

[1] Its constitution was adopted on 13th March, 1929

CHAPTER V

YIELD

VALUATION of shares and bonds involves problems in probability Security and marketability are the essentials to be borne in mind The way these are viewed finds expression in the relative yields offered by different classes of securities at current prices

The main distinction between shares and bonds is that in the former attention must be paid to prospects of capital appreciation, whilst in the latter there is, as a rule, no capital appreciation or a known amount In all types of bonds, then, the yield is given, and the task of comparing different classes of bonds is facilitated

The yield is, perhaps, the first consideration which influences the overwhelming majority of investors Security and marketability are matters on which experienced people only, usually professionals, lay full weight But what is a high and what is a low rate of interest?

Little can be learnt as to this matter except upon the basis of comparison, expressed or implied Securities are low or high only as compared with their value on another day, or with some accepted average or with another class of securities They may be low in contrast with Government bonds, or with industrial debentures Statistical and other data may be available to make such comparisons with precision, and to enable sound judgments to be arrived at But even when they are altogether wanting they are implied in most conclusions

But is the rate of interest, alone, a useful guide as to the value of securities?

The man who purchases a bond in 1930, maturing in 1940 at 90, which gives 6 per cent, will, of course, receive a return in excess of this The actual flat rate of return is 6 6 per cent But in addition to this rate of interest, he will receive at the end of 1940 a principal sum of £100, or £10 more than his purchase

price This may be regarded either as a capital increase, or as an income In either case, there will be a steady appreciation in the value of the bond each year from the date of its purchase until it matures The yield is, therefore, actually 7 per cent

Thus where mortgage banks are quoted to give a certain rate, this by itself means little We need to know the three factors which determine the effective yield of a security its price, its maturity date, and the rate of interest A bond selling at 60, giving a 5 per cent rate which has ten years to run till maturity, is really cheaper in terms of income than a bond selling at 95 giving 8½ per cent which has only two years to run The investor, therefore, is really far more interested in the yield, in the return which he receives during the tenure of his investment, than in the nominal rate of interest [1]

Here one must note the difference between American and English usage in quoting the current price In the U S A prices are quoted "and accrued dividends," i e they are quoted with interest deducted In England the price contains interest, or if quoted just before dividend is about to be distributed is said to be "full of dividend" No principle is involved, it is only a question of practice The American notion is that the owner of a bond is entitled to the dividend on it as long as he holds it, and the new owner's right to dividend should begin on the day of purchase In England the seller sells his whole equity In comparing the yield on bonds in different countries, it is necessary to allow for the different usage in quotation

[1] Bond tables have been compiled by means of which it is possible to determine at a glance the exact yields of given securities if the price at which the bond is selling, the rate of interest, and the length of time until maturity are given These bond tables give the prices worked out for an extended range of maturities, rates of interest, and yields The method of use of these tables—the Rollins, the Sprague, and the Equitable tables—is easily grasped

Rollins, Montgomery *Bond Values*, 1919 (Financial Publishing Co, Boston)

Sprague, Charles E *Completed Bond Tables*, 1915 (The Ronald Press, New York)

Bartholomew, James P *Equitable Trust Company of New York, Rapid Bond Tables*

It has been assumed in the examples given above that bonds are to be redeemed at par

COMPARISON OF YIELD ON GOVERNMENT AND MORTGAGE BONDS FOR TEN-YEAR PERIOD, 1903–1913 [1]

Germany		
Mortgage Bonds	3 89	
Government Bonds	3 71	
Percentage difference		5%
Hungary		
Mortgage Bonds	4 51	
Government Bonds	4 32	
Percentage difference		3%
Norway		
Mortgage Bonds	4 24	
Government Bonds	4 12	
Percentage difference		3%
Denmark		
Mortgage Bonds	4 04	
Government Bonds	4 25	
Percentage difference		-5%

Comparing the yield on Government and mortgage bonds for the ten-year period 1903–1913, we find that in Germany, Hungary, and Norway the mortgage bond gave a slightly higher yield Mortgage banks had to pay more for their loans than the Government In Denmark, it will be observed that the mortgage bond was regarded as a better security than the Government bond This was also the case in France where the Credit Foncier was able to obtain capital at under 2 per cent at certain periods, and before the war paid only 2½ to 3 per cent on its bonds This is due in part to the lottery features which accompany the repayment

Let us note in some greater detail the position in Germany for the period 1910–1913

At that time bonds on a 4 per cent basis were usual, although the 4½ per cent bond was increasing The former, therefore, were standing below par

[1] J H Gray and G W Terborgh *First Mortgages in Urban Real Estate Finance*, p 21 Dr Wolfgang's study, *Die Kursbildung am Rentenmarkt*, suggests that these figures are altogether too favourable for mortgage bonds

The average yields were as follows—

	1910	1911	1912	1913
On 4% Government Bonds	3 93%	3 96%	4 03%	4 12%
On 4% Mortgage Bonds	4 01%	4 03%	4 15%	4 29%

The Government bonds included loans of the Reich, as well as of Prussia, Baden, Bavaria, Bremen, Hamburg, Hessen, Oldenburg, and Sachsen-Weimar The mortgage bonds covered a great variety of issues with different dates of repayment and recall Both kinds are therefore typical Mortgage bonds gave slightly higher yields than Government bonds, which means that this class of security was regarded as only a shade less desirable than Government bonds Broadly then, the original object of mortgage bond legislation in most countries of creating a very secure class of bond had been achieved during the decade preceding the war, and this not in one country, but in all countries where this new device was adopted During the decade after the war the basic yield has greatly changed in most countries, and especially in Germany Early in 1931 lenders kept their liquid resources in deposits, or invested them in the main in gilt-edged securities The diminution in the supply of capital owing to the great waste during the years of war, and the increased demand resulting from the opening out of new areas, the development of new industries and new methods of organization and the exploitation of new inventions, have resulted in an increased rate of interest in the world market At the same time certain countries have suffered even more from monetary and political *malaise*, and, consequently, they are not lending capital excepting at very high rates to cover the additional risks

Interest rates in Germany, to-day, are comparable to those in the U S A between 1877 and 1879 The rather sharp drop in price in America, and the corresponding advance in yield from 2½ to 4 per cent, was due largely to doubt as to the ultimate resumption of specie payments, and the discharge of Government debt in gold rather than in paper currency As

soon as it was made clear that specie was to be resumed the price of Government bonds rose sharply, so that the yield on them dropped to a little more than 2 per cent In Germany, previous to the war, mortgage bonds, as we have seen, bore interest, as a rule, from 3½ to 4½ per cent per annum Since 1924 they have borne an interest between 7½ and 10 per cent This rate is due to the lack of capital, and to fear that, owing to the imposition of reparation payments and the consequent likelihood of high taxes and labour unrest, to say nothing of political disturbances, Germany may be unable to pay her way and, perhaps, be forced through a new cycle of inflationary troubles The result of this is a scarcity of capital for all purposes, for public loans, industrial debentures, as well as mortgage bonds and the high rates they must pay for long time issues But it will be seen later that there is now a wider difference between Government bonds and mortgage bonds than in the ten years preceding the war, and the yield on mortgage bonds remains generally much below that on Government bonds

The following calculations are based on the fortnightly yield of 8 per cent German mortgage bonds, as well as of 8 and 7 per cent German Government bonds for 1928, and for the first eight months of 1929[1]

REDEMPTION YIELD

	7% Mortgage Bonds	8% Government and State Bonds	7% State and Provinces
1928	9 4%	8 6%	8 5%
1929 8 Months	9 9%	8 8%	8 9%

Similar calculations, comprising securities bearing a fixed

[1] The figures are for a certain number of securities of each class quoted on the Berlin Exchange, and were prepared by the Dresden Bank

rate of interest, are classified in the following table according to their nominal rate of interest—

REDEMPTION YIELD ON DEBENTURES

		10%	9%	8%	7%	6%	5%	Average
Government's State Bonds	1928 6 months	8 4	8 8	9 9	9 0	8 8	7 2	9 0
Mortgage Bonds	1929 8 months	8 9	8 9	10 7	9 5	9 4	7 1	9 6

It is clear that about 1 per cent more must now be paid by mortgage banks than by Government State and provincial authorities Since the most serious cause of high rates in Germany are political, one should have expected that mortgage bonds would now be regarded as a better rather than a worse security than Government bonds Thus one might argue that if German Government bonds are to-day properly estimated, then mortgage bonds are heavily under-estimated Thus, if Government bonds must pay 9 per cent, mortgage bonds ought to pay, say, 7½ or 8 per cent instead of 9½ or 10 per cent. In 1930 this tendency began to show itself to some extent Mortgage bond prices began to rise so that their yield gradually declined to that of Government bonds, and since purchasing still continued it is anticipated that with freer investment the prices of mortgage bonds will continue to rise

In America, too, mortgage bonds do give a yield substantially higher than municipal or industrial shares Here the spread between the yield on municipal and mortgage bonds may be actually near 50 per cent But the American mortgage bonds are not only new, but are, consequently, not so well regulated They are still not regarded as seasoned investments The monthly average of yields of fifteen high-grade bonds in each of four groups as compiled by the Standard Statistics Company are given in the first four columns, and

then the figures of average gross yields earned by the mortgage investments of all important companies prepared by the Institute of Research in Land Economics and Public Utilities

	Fifteen Railroads	Fifteen Industrials	Fifteen Public Utilities	Fifteen Municipals	Mortgage
1920	5 79	6 01	6 73	4 98	6 08
1921	5 57	5 96	6 56	5 09	6 27
1922	4 85	5 21	5 46	4 23	6 47
1923	4 98	5 26	5 41	4 25	6 35
1924	4 78	5 21	5 22	4 20	6 19
1925	4 57	5 06	5 06	5 09	6 07
1926	4 51	4 91	4 90	4 08	—
1927	4 31	4 83	4 78	3 98	6 11

Another estimate of the mortgage loan rates of insurance companies shows that it is ½ to 1 per cent higher than the market yields of high-grade bonds—

Class of Loans	1921	1922	1923
Mortgage Loans	6 46	6 03	5 36
High-grade Bonds	5 79	4 94	4 98

Why does the yield on real estate loans ordinarily exceed the yield on high-grade bonds? This may be explained in part by the cost of handling, and in part by the lesser marketability The administrative expenses on the former are higher Real estate mortgages require careful and frequent appraisals, examination of title, and supervision of insurance policies This costs about ½ per cent even when the sums involved are large The customary rate for mortgages being 6 per cent in the U S A , the net return will be about 5½ per cent as against, say, 4 9 per cent on other classes of investment This 0 6 per cent is paid for the difference in marketability, assuming that the security of high-grade mortgages and industrial bonds is the same The development of a nation-wide market, it is

expected, will result in lowering the yield of mortgage bonds by ½ per cent

To complete the picture, let us now compare the average yield of high-grade bonds with those of the Federal Farm Loan Bonds, i e those which are issued under Government supervision, which are trustee securities, and are tax exempt

RATES OF THE FEDERAL FARM LAND BANKS AND YIELDS OF FEDERAL FARM LOAN BONDS, 1919–1925

	Average Yield of Sixty High-grade Bonds[1]	Yield at Issue of Federal Farm Land Bonds[2]	Loaning Rate of Federal Farm Land Banks
1919, May	5 17	4 46	5 50
1921, May	5 91	5 00	5 50
1922, May	4 94	4 50	6 00
1923, April	5 00	4 47	5 50
1924, July	4 80	4 62	5 50
1925, July	4 66	4 15	5 50

The tendency is for the Federal Farm Loan System and the Real Estate Exchange to lower the mortgage loan rate of the other agencies[3]

What is the explanation of this wide and (judging from pre-war experience) unjustified spread? A distinction needs to be drawn between controlled and uncontrolled bonds, and between countries like Germany, which has had great experience in these matters, and the United States, whose experience is limited Let us deal first with the case of Germany

The judgment of the market in estimating risks is generally

[1] Published by Standard Statistics Co in *Annual Statistical Bulletin*, 1926

[2] *Industrial Prosperity and the Farmer*, by Russell C Engberg, p 116 This study discusses the relation between money market and mortgage loan rates It is evident from these figures that the mortgage loan rates do not correspond closely to the condition of the market

[3] This applies to normal conditions when the capital flow between countries is not interrupted But at a time like this (May, 1931) the resumption of capital loans would tend to have the effect of lowering rates much more

very good when conditions are comparatively stable Any unjustified return, whether regarded as too high or too low, is righted in time by the flow of capital to it where the rate is high, and away from it where it is low But once a major disturbance occurs, such as that in Germany after the war, the market has no means of measuring the present risk It is a little wild. A rather limited group are interested, deals are rare, and a wide spread of prices often occurs Of course, these unjustified differences are eliminated in time But, owing to her lack of capital, this may take a comparatively long period in the case of German bonds

One of the most important factors affecting the rate of interest on international securities is the ability of the country of issue to absorb large offerings from other countries, when they grow tired of them or apprehensive as to their future Germany, owing to her lack of capital, has been unable to do this Her mortgage bonds have suffered more in this respect than the Government bonds, precisely because few of the investing countries know their merits Similarly, a constant flow of new capital must be available in the case of local issues if unjustified differences in yield are not to arise

The low valuation of the unregulated mortgage bonds in the U S A is not quite as great as it appears to be, since the whole system of mortgage bonds and the technique still being new the securities are not as sound as they are abroad But even here the public still does not sufficiently appreciate the merits of this type of security The situation is entirely different with respect to the bonds of the Federal Farm Board banks

Supposing now that an investor has decided to purchase mortgage bonds, he will find that the yields obtainable vary enormously These differences may be explained on geographical grounds and because of certain special characteristics The variation in the yield of mortgage bonds in different countries are very striking From roughly 9 5 per cent in Germany and 7 per cent in the Argentine, it descends to 5 per cent in Great Britain and to slightly less in Sweden and

in France These variations cannot be explained by reference to the special characteristics of the securities themselves, such as the degree of risk, the maturity of the issue, marketability, etc This is demonstrated by the fact that Government securities show a similar divergence These are influenced by two main considerations—the absence of a free flow of capital from one country to another, and the comparative political instability of certain countries

Investment abroad involves exchange fluctuations, and these, in the case of a number of countries like Germany and the Argentine, have been very serious, and in the opinion of the market the risk of their recurrence has considerable weight There is also the reluctance to commit funds to countries where events cannot be easily foreseen, and political disturbances are judged to be not too remote Another important factor affecting normal yields is the stage of development reached by any country In new and undeveloped territories, the risks of investment are likely to be higher because of the less stable nature of the government and of its institutions, the uncertain enforcement of the law, the newness of industrial ventures, the lack of knowledge as to who is trustworthy Nor can it be denied that in new and growing countries the opportunities for highly productive uses of capital are still open, so that good returns are available and, therefore, lenders are justified in borrowing at comparatively high rates Each financial market is, therefore, within certain limits dependent upon the local supply of and demand for capital Each country has its own interest rate, and this varies from that found in other markets They constitute, indeed, to a certain extent non-competitive areas

Specific factors affecting mortgage bonds which explain price differences within a country are their recognition as trustee securities, their taxation status, and the operation of a sinking fund Every country has its own particular laws defining trustee securities In nearly all countries, Government and municipal funds and often railways are recognized, in some, public utility bonds, but in many countries mortgage

bonds enjoy this advantage. This recognition makes a security one of a favoured class in which certain funds must be invested, and which inspires confidence amongst practically all investors.

Another special advantage sometimes given them by the Government of the country of their origin is to make them free of certain taxes. The German Government has given this concession to mortgage bonds intended for sale on the foreign market; the mortgage bonds issued under the U.S.A. Federal Farm Loan System enjoy a tax exemption, and many of the mortgage bond issues of the Middle and South American countries are equally privileged.

The provision of a sinking fund for the retirement of an issue on a serial basis has, as its object, the withdrawal of all or of a portion of the bonds before maturity. The setting aside of a definite, predetermined sum annually for the purpose of building up a sinking fund to retire the bonds at maturity, or to retire a certain amount of the bonds regularly, increases the equity behind the issue. It becomes better secured either through the growth in the sinking fund assets, or by the reduction of the amount outstanding. This, therefore, tends to keep their price high and steady.

One of the characteristics of mortgage bonds usually stressed is their comparative price stability. Compared with ordinary stocks and shares they change little in price. How do they compare in this respect with other types of bonds?

The calculations given on page 82 show the development in prices of German bonds in 1928.

The spread in German mortgage bonds over the year expressed in percentages was 3·84, of communal bonds 3·21, of mortgage bonds issued by public banks 3·89, of Government bonds 2·47, of loans of provinces and towns 2·93, industrial bonds 4·92. In fact, they are less stable than Government and more stable than industrial bonds.

It is frequently assumed that one of the differences between investment in bonds and investment in shares is that the former affords no opportunity for capital appreciation, whilst

the latter does This can easily be shown not to be the case Let us consider a bond whose credit position improves This may be due to factors affecting the bond itself Take the case of an Argentine mortgage bank bond, or a bond issued by the Argentine Railways Their credit position may improve because the market begins to view that country more favourably The rise in the price of these bonds would then occur earlier, and not have to wait until towards the maturity date This is what is likely to occur with German mortgage bonds if political unrest does not prevent it Thus, if the effective rate of mortgage bonds to-day is 9 per cent, and owing to political appeasement they go down to a 6 per cent basis, then there will be a rise in their market price They will soon be quoted well over par Still another kind of operation is possible in the purchase of bonds Where a general reduction in investment rates on capital occurs, the yield of all new bonds is lowered and a profit accrues to existing bondholders as a class In recent years this class has enjoyed

PRICES OF DIFFERENT CLASSES OF GERMAN BONDS[1]

	Mortgage Bonds	Communal Bonds	Mortgage Bonds issued by Public Banks	Government Bonds	Loans of Provinces and Towns	Industrial Bonds
1928	91 67	90 26	90 88	—	89 14	89 00
January	93 99	92 03	93 08	89 44	90 91	92 30
February	93 48	91 54	92 63	88 76	90 39	90 85
March	92 75	91 18	91 98	88 01	89 96	89 73
April	92 40	91 01	91 70	87 59	89 52	89 58
May	92 03	90 73	91 41	87 37	89 02	89·11
June	91 75	90 28	91 00	86 97	88 99	89·05
July	91 41	90 04	90 48	89 46	88 96	88 76
August	91 00	89 81	90 20	89 18	88 92	88 22
Sept	90 61	89 61	89 89	88 36	88 84	87 89
October	90 25	89 17	89 64	88 08	88 27	87 38
Nov	90 15	88 89	89 40	88 07	87 98	87 40
Dec	90 22	88 82	89 19	88 32	87 98	87 64

[1] G Plum, "Das Hypothekenbankjahr, 1928," *Bankwissenschaft*, 20th May, 1929, p 143 It is to be regretted that Dr Plum does not indicate the rate of interest of these bonds, nor whether they represent a combination of different classes

a substantial appreciation in the value of its holdings But it should be noted that there is little additional gain for these people in realizing them Having sold a given bond they are compelled to reinvest at a time of lower interest rates Supposing a bond bought on a 7 per cent basis in 1923 is now issued on a 6 per cent basis The price of the former goes up, let us say, from 100 to 115 If the investor sells out his former holding and buys the latter he is no better off Thus the holder may profit from the purchase of bonds selling at a discount and holding until maturity, or by buying bonds that are below their true values or whose status is likely to improve, and holding them until the market recognizes their value and then selling them, or from the general rise in value of bonds consequent on a lowering of the rate of interest

No reference is made to the possibilities of capital appreciation arising from monetary uncertainties The fear that a country will be forced off the gold standard results in a heavy decline in the value of all its securities in foreign markets If these fears are not justified or exaggerated, capital appreciation will result to those who bought bonds at the low prices

It will be useful now to summarize the attractive qualities as well as the weaknesses of mortgage bonds as a security Under normal conditions the mortgage bond constitutes one of the safest classes of securities Issued by mortgage banks which do not suffer from cut-throat competition and consequent instability of earnings, their capital is well placed, whilst their tasks in the matter of control and collection of interest are simple The legal supervision of their bonds, the fact that the investor has a first lien on assets and earnings, the past record of their reliability, are characteristics which are not sufficiently appreciated by investors They constitute a class of security of which the market estimate of risk is greater than the actual risk In spite of the constant effort of promoters to introduce new safeguards into other securities, none is so well secured as the mortgage bond

But the mortgage banks themselves, and the bonds they issue, are likely to have different degrees of security into which

the skilled investor must inquire The uninstructed will find the problem of selection less difficult than in any other type of holding, because of the nature of the security and the limited range of fluctuations There are a variety of types of mortgage bonds, and all have developed a series of defences in order to make them secure The comparison of mortgage bond yields with those of other bonds previous to the war, showed that mortgage bonds were regarded then as the very highest type of security, practically as good as those of the most powerful governments The situation has changed somewhat since the war, and the mortgage banks are obliged to pay more for loans than is paid for similarly secured bonds It is for this reason, apparently, that they offer now more than any other class of bond the maximum return consistent with the actual risk Let us examine this point in some detail The intelligent investor advised to purchase mortgage bonds desires to have a comparison made between the yields obtained by investment in mortgage bonds, in Government bonds, in municipal bonds, and in industrial debentures [1] To him they are interchangeable securities of the type which constitute a relatively secure investment, guaranteeing safety of principal and giving a predetermined return, and enjoying, as a rule, ready marketability They are all subject to such influences as a rise or fall in the long time interest rates or in short time money rates But, of course, they do differ, and the difference is greatest in the nature of the security behind them Indeed, since the marketability of certain mortgage bonds and Government bonds is about the same, differences in yield must be due to their difference in security

What indexes are to be studied in connection with Government bonds raised by way of foreign loans?

1 What is the international standing of the borrowing Government in respect to her credit? This would be affected by its revenue and expenditure, the fixed and current assets,

[1] Of course, he should realize that the distinction between shares and bonds is not that between uncertainty and no uncertainty, but between more uncertainty and less uncertainty

potential wealth, indebtedness at home and abroad, and its record in debt payment, especially to foreigners Some argue that a borrowing country ought to be able to show a normal surplus of exports over imports

2 For what purpose is the loan required? Is it for war expenditure, or for repaying existing debt or for capital development purposes?

3. Is the borrowing country in a position of political stability at home and abroad? The answer in regard to the former point may depend on whether there is an accepted constitutional regime, and a normal industrial and social development in the country in question The trade union movement and the employers' organizations may be heading for strikes or even general industrial conflict Wars, or even threats of war, may gravely imperil the credit of a country

4 Is the currency in which interest and capital are to be paid likely to be stable?

Clearly, these tests may be misleading if they are not judiciously applied Thus, new countries with great resources might not be able to have an export surplus, and yet constitute good channels for investments But they indicate the kind of factors that must be examined Another condition remains to be added to the list The security of a bond may be strengthened by the grant of a specific additional security—a first charge on Customs' duties, a tobacco monopoly, or the kind of security behind the Brazil coffee scheme But even in these cases the National Revenue remains as an additional security On the other hand, it should be noted that most Government and municipal loans are not specifically guaranteed, except in the case of young Governments or those older Governments whose financial position is regarded as weak

The main objection to the Government bond arises from the possession by the State of a sovereignty which enables it to deal as it thinks fit with the public creditor Governments cannot be sued in a Court of Law for debts Their methods of borrowing, their plans for repayment, and, in extreme cases,

their power of repudiation, make them in effect independent of external control

Subsidiary Government bodies are limited in respect to the amount, the term, and the form of loans Their loans can be contracted only under the sanction of the appropriate authority They are subject to supervision in order to prevent improvident usage of revenue and property The creditor has the right of claiming the aid of the law against a defaulting municipality The chief purpose of local debts is the establishment of reproductive works The main weakness of municipal loans lies not, as is sometimes suggested, in the inability of the municipalities to levy important duties or an income tax, but results from the fact that public opinion is not as vigilant over local as it is over central Government budgets There is the same need for a well-prepared account if there is to be clear and accurate financial management, but public criticism is, as a rule, lacking for the local budget Frequently they take advantage of this fact to borrow too heavily

The orthodox view respecting debenture-holders of industrial companies used to be that they were not proprietors, but creditors They had no need, therefore, to worry about fluctuations in earning power In the last resort they could foreclose on property, and as this was, as a rule, valued at more than the amount of debentures issued, the security was regarded as absolutely safe But, in fact, the prior rights of the debenture-holders to income and to capital are not always realizable Recently, there have been numerous cases in which companies which have fallen on bad times have compelled them to give up their prior rights [1] The conclusive argument is that if a receiver were appointed, the assets would not realize enough to pay off the debenture-holders In industries in which buildings, plant, and machinery are a high percentage of the capital, such as iron and steel concerns or coal-mines, debenture-holders have found it more profitable to

[1] E g the recent reorganization schemes of Armstrong Whitworth, Pearson and Knowles, Baldwins, United Steel, and English Electric Company in Great Britain

give up their mortgage rights, partly or wholly, than to foreclose In the Vickers reconstruction scheme, assets standing on the books at £12,500,000 were found to be almost worthless, and the £1 shares were written down to 6s 8d The writing off of two-thirds of the face value of the shares of the company was a mere recognition of the fact that heavy losses had already been made The change makes no difference whatever to the earning power of the company or to the value of the property Industrial debentures and preference shares, as well as ordinary shares, are liable to be written down if business is bad The purchase of industrial debentures therefore calls for great care, and a high standard of knowledge and intelligence, and once purchased they require watching

The mortgage bank when issuing a loan offers a specific, as well as a general, security—the specific security being the actual mortgages on the property, which are worth considerably more than the total amount of bonds issued, and the general security based on the general assets of the bank Default by mortgage banks to meet their obligations has been very rare, excepting in times of a general financial catastrophe Government troubles of a purely political nature have, as a rule, little effect on mortgage bonds Even strikes, political revolutions, changes of taxation, the non-balancing of budgets have had only a small indirect effect on the value of bonds secured on real estate But during a general loss of confidence, whether due to political or economic causes, mortgage banks are also affected Broadly, however, whilst Government and municipal loans have, as a rule, the guarantee of the public authority with its taxation resources, industrial companies and mortgage banks are based on private credit backed by goodwill, tangible assets, and ability to make profits Management remains of key importance In Germany, towards the end of the nineteenth century, and in America to-day, mortgage banks have failed in spite of supervision or experience

When, however, an examination is made of the number of States which have at one time or another defaulted, and one

contrasts them with the cases in which mortgage banks have failed, one is compelled to take the view that the bonds of the latter are as safe as the bonds of the former Not only Turkey, and the States of Central and South America which are generally known to have been guilty of default, but most States at some time or another have failed to meet their obligations Destructive policies and maladministration or mismanagement of revenue, even where there has been insufficiency of resources, have often resulted in recurrent deficits

Indeed, it has been contended recently that a very large proportion of the sums invested abroad by Great Britain in foreign loans, in Government securities, and in industrial undertakings has been wasted [1] A commission of investigation of the foreign loans issued on the London Stock Exchange between 1828 and 1878 concluded that about 40 per cent out of 614 millions, some 212 millions, had been lost It is argued that the present haphazard indiscriminating policy of oversea lending has been proved to be extremely costly, and expert guidance is needed

Contrast now with these characteristics the main features of the mortgage bank Unlike Governments which may borrow for political objects, the mortgage bank grants loans only where economic development is the predominant motive Unlike the industrial debenture which is raised and spent by the same company, the mortgage bank obtains loans under conditions which imply a State supervision of a strict kind, whilst it, in turn, exercises supervision over the ultimate borrower Unlike the State, the bank is limited in respect to the amount and form of the loans Unlike the industry its risks are limited

The principles of company investments are fully applicable to mortgage banks, the avoidance of the formation of fictitious

[1] "Has Foreign Investment Paid?" by Arthur Michael Samuel *The Economic Journal*, March, 1930 It should be observed that a very high percentage of foreign loans takes place in the form of fixed yielding securities, but, as previously observed, have rarely taken the form of investment in mortgage bonds

capital, the creation of sinking funds, the fixing of the term of each loan to the time at which the return from its employment ceases, are guiding rules which the ordinary investor understands But whilst he requires direct knowledge if he is to invest in industrial debentures, he may invest in the bonds of a leading mortgage bank with confidence The conclusion emerges that the bonds of a well-managed mortgage bank are safer than those of the average central or local Government, and very much securer than industrial debentures But the mortgage bond is not, as a rule, as marketable

In spite of modern developments and in spite of local interests, the absence of a satisfactory organization results in real estate mortgages commanding a narrow market, they are difficult to investigate and, therefore, lack liquidity At the same time, investors without elaborate organization for appraising them are reluctant to invest in them Thus, although the mortgagor, the borrower, is willing to pay a high rate to the lender, the mortgagee cannot safely take advantage of the attractiveness of the yield We have seen that the narrowness of the market can be overcome through the mortgage bank and the mortgage bond But here, again, the question of liquidity of securities is raised Unless the bond can be made marketable, the mortgagor will have to pay a high rate for the loan Marketability requires increasingly the interest of foreign capitalists National interest therefore demands an international organization Without such a highly-organized market, the development of real estate—urban and rural—is more costly than it need be

The advantages usually claimed for mortgage bonds may be tabulated as follows—

1 A clear title to a part share of certain specified properties

2 Real property as basis of the security

3 Conservative appraisal of its value and its possible improvement

4 Adequate margin of safety

5 Higher income than any other security of equal merit

6 Moderate fluctuation in prices

7 High marketability within the country of issue

8 A security which can be borrowed upon

9 A security which will run for a long time

10 A security which requires little attention

11 Acceptable denomination

12 Prompt settlement in cases of dispute owing to the legal regulations

13 The bonds are often tax exempt, at least when issued on the foreign market

14 They are generally trustee securities

This may be summarized briefly Mortgage bonds are relatively under-valued

The analysis of the earlier chapters point also to a number of dangers in mortgage bond investment These result from the evils of monetary *malaise*, and of violent changes in the rate of interest—from which, be it noted, other bonds also suffer

Whenever any country is unable to balance its budget, or for any other reason is threatened with a period of inflation, the value of its fixed securities declines The danger is lessened somewhat by a promise to pay in sterling or in the currency of some stable country, but the fears of a paper currency and inflation and the tidal consequences are not entirely eliminated But assuming that the country whose bonds we are interested in still maintains the gold standard, then a peculiar danger results during periods of monetary excitement which increase the opportunity for reckless gambling Special facilities for mortgaging real estate will then be sought Excessive optimism may grow contagious and new properties recklessly constructed Still, experience shows that these pyrotechnic happenings are less important in the long run than the less perceived changes in the purchasing power of money During periods of rising prices the real value of the dividend declines, whilst at the same time there is capital depreciation, and the reverse occurs during periods of falling prices If, as seems likely, we are about to see continuing falling prices, then fixed

yielding securities will be a good type of investment Mortgage bonds are long period investments in which long time money phenomena have the opportunity to work themselves out The short period results may be very different from long period effects

Certain countries have recently had to pay very high interest rates, because of the lack of capital in comparison with the demand for it Mortgage banks in these countries have been obliged to issue high yielding bonds But these attractive rates can be stopped in the case of those issues which have a redemption clause operative at an early date It should be noted that where the yield on bonds is high, the rate on which loans are made must be very high, so that productive industry may be stifled under it, and this in the long run may prove harmful to the security of the mortgage bond The same effects follow from the low profits and high taxation, which have been the lot of agriculture in recent years Mortgaged property if thus crippled will have little value when taken over by the bank

CHAPTER VI

THE MORTGAGE BANK AT WORK

INVESTMENT theory requires to be elucidated by the constant reference to history, just as, in turn, the history of security prices has to be interpreted by the aid of general principles Every type of security has its own peculiar problems which call for special treatment, though, at the same time, there is no way of avoiding the operation of those economic conditions and forces that affect all securities

It may, therefore, be useful to illustrate some of the tendencies and problems relating to mortgage bonds in general, by reference to a series for which we have detailed facts over a considerable period By following the quotations of the Mortgage Cédulas of Argentina from 1908 to 1928, we will obtain a clear and exact picture of the developments of these bonds and the variations in their price, and it may be possible to discover some reasons for them First, however, let us note some more general facts

Argentina has fifteen mortgage banks, of which twelve are national and three are foreign The largest with a bond dealt in internationally is the Banco Hipotecario Nacional. It is a State bank, established in 1884 for the purpose of "facilitating the grant of loans on mortgages throughout the Republic, based on the issuance of mortgage bonds which are to be redeemed by means of an accumulative amortization fund" It has no capital stock, and does not aim at making a profit The board of directors is appointed by the President of the Republic The National Mortgage Bank of the Argentine belongs to the type of central mortgage bank owned and controlled by the Government, which is to be found also in Chile, Colombia, and Yugoslavia It has the exclusive right of issuing bonds secured by mortgages on property located in the capital of the Republic and the national territories But this does not deprive the governors of the autonomous provinces

from authorizing the creation of mortgage banks with the power of making loans on property situated in their respective areas

The bank operates with the funds obtained through the sale of cédulas, a species of bearer bond At the time of its organization the Government established a credit of 2,000,000 pesos in its favour for administrative expenses and as an additional guarantee fund

The Bank grants chiefly agricultural loans, but gives also credit on industrial buildings and house property, i e on all income producing property Loans are secured by first mortgages on unencumbered, improved, or agricultural property to which the owner has a clear title Mortgage loans may be granted also on buildings in process of construction, special provision is made for loans up to 6,000 pesos for the construction of houses for labourers, which may rise up to 70 per cent of the appraised value The law governing the operations of the bank states specifically that loans may not be granted on mines and quarries, or on property leased for a period of more than five years from the date of the proposed loan contract

The amount of the loans is within the discrimination of the Board, but an upward limit is set In 1929 it was usual to lend 40 per cent of the value of property, and 20 per cent of the value of any improvement was taken into account In the case of loans to corporations, the loans are restricted to 30 per cent of the appraised value Loans on amusement places are made up to an amount of 25 per cent of the value

On 15th June, 1930, the President decreed an increase of mortgage Cédulas to 50 million pesos paper This was the first increase under the law authorizing the expansion of the total amount from 1,500 million to 2,000 million pesos paper

1926	Pesos
Total bonds outstanding	1,268,071,800
Total loans granted for buildings	137,000,000
Total loans granted for urban buildings	81,000,000

Mortgaged property cannot be leased or sold without the approval of the bank

The loans granted are 33 years cumulative amortization

loans The annual payment of the borrower amounts to an interest charge of not more than 6 per cent, plus 1 per cent amortization, plus 1 per cent service charge for the first ⅓ of the period, ½ per cent for the second part, ¼ per cent for the third part of the period In case of default in any payment, the bank has the right of foreclosure without proceedings in the Courts after a lapse of sixty days

The loans are ordinarily made in Cédulas, in units of 1,000, 500, and 100 paper pesos Thirty-five series of 50,000,000 each are now in circulation The borrower sells these in order to obtain the cash he requires Each series of the bonds issued has its own separate sinking fund The payment of interest and sinking fund is guaranteed by the Government The bank offers the extraordinary spectacle of issuing its bonds at 6 per cent whatever market conditions prevail, with the one

MOVEMENT OF NATIONAL MORTGAGE CÉDULAS
(In thousands of dollar notes)

Years	Circulation as on 31st December	Cedulas Issued	Cedulas Withdrawn	Stock Exchange Transactions in Cédulas[1]
1908	168,200	27,500	14,700	63,100
1909	199,900	52,400	20,700	158,000
1910	272,100	98,800	26,600	143,300
1911	358,900	115,900	30,000	182,800
1912	463,800	140,600	34,800	271,200
1913	520,700	91,100	34,200	197,700
1914	556,200	49,900	14,400	186,400
1915	540,600	—	15,600	102,100
1916	532,700	9,300	17,200	111,100
1917	562,000	49,700	20,400	137,800
1918	605,500	81,300	37,800	135,400
1919	623,900	94,900	76,500	285,200
1920	629,600	50,700	45,000	306,700
1921	706,200	128,800	52,200	351,700
1922	916,700	273,600	63,100	627,300
1923	1,002,200	147,600	62,100	655,800
1924	1,103,700	159,000	57,500	391,800
1925	1,191,400	141,800	54,100	347,600
1926	1,268,100	137,100	60,400	369,800
1927	1,344,100	142,500	66,500	357,900
1928	1,429,800	147,600	61,900	364,600

[1] Nominal value

exception of the 1905–1938 issue which was on a 5 per cent basis, and which has been retired in large part This means, of course, that they have to be sold on the market at varying prices

Argentine Cédulas have an unusually wide international market, being dealt in on the Stock Exchanges of Buenos Ayres, Santiago, London, Amsterdam, Brussels, Madrid, and other European centres Prior to 1914, 90 per cent of these Cédulas were held by European investors They are now regarded as one of the best investment securities in South America, and are held very largely in the country

In the course of twenty years there has been a ninefold increase in these mortgage Cédulas With the exception of 1915, when the initial disturbances due to the war caused a substantial drop in their quotations, Cédulas were issued annually Since 1920 there have been issued at least one hundred thousand per annum, whilst, as a rule, less than a half of this number have been withdrawn The considerable increase in the issues of recent years was due to the new agricultural and land settlement schemes encouraged by the Government As might be expected, the number of Stock Exchange transactions in this security has greatly increased In brief, the mortgage Cédulas have grown in importance as a field for the investment of national savings

Stock Exchange Transactions in the First Two Months	In thousands of million dollar notes[1]			
	1926[2]	1927	1928	1929
National Public Bonds	9,900	10,800	14,000	12,300
Provincial and Municipal Public Bonds	7,000	6,300	12,000	14,200
National Mortgage Cedulas	46,500	45,800	52,500	45,100
Mortgage Bonds	2,700	5,500	9,100	7,100
Shares	5,700	14,800	11,300	7,900
TOTALS	71,800	83,200	98,900	86,500

[1] The gold peso is nominally equal to 47·58d, and 44 gold pesos have the same value as 100 paper pesos

[2] Figures for 1926 are estimates

Some conception of the very great part now played by National Mortgage Cédulas on the Argentine Stock Exchange may be obtained from the figures given on page 95 referring to transactions in the first two months of recent years

It is evident that nearly 60 per cent of all transactions on the Argentine Stock Exchange relate to the National Mortgage Cédulas alone Perhaps in no country in the world are mortgage bonds such a popular security This is due in part to the very large number issued, and in part to the fact that they are Government guaranteed

Let us compare the price quotations and yields of a number of different issues of Cédulas in recent years The quotations given are for February

QUOTATION IN FEBRUARY

The Issue	1926	1927	1928	1929
Ced Law 10,676, Seventh Series	95 53	97 07	99 38	100 72
Céd Arg Int, 1913, 6%	95 05	94 38	98 18	100 33
Ced Arg Int, 1911, 5%	85 17	84 67	86 58	91 75

YIELDS CALCULATED ON FEBRUARY PRICES

The Issue	1926	1927	1928	1929
Ced Law 10,676, Seventh Series	6 28	6 18	6 04	5 96
Céd Arg Int, 1923, 6% (im)	6 31	6 36	6 11	5 98
Ced Arg Int, 1911, 5% (im)	5 87	5 91	5 78	5 45
Ced Arg Int, 1911, 5% (net)	6 43	6 52	6 36	5 86

It should be noticed that it does not make any serious difference whether the Cédula is on a 5 per cent or, as is now usual, on a 6 per cent sterling basis The market price is adjusted to the yield obtained from the different securities. It is clear, also, that all are influenced in the same direction by market conditions with respect to money

NATIONAL MORTGAGE CÉDULAS

In 1926	the average for 28 series issued subsequent to 1920 was	95 90
In 1927	,, ,, ,, ,, ,, ,,	97 56
In 1928	,, ,, ,, ,, ,, ,,	99 39
In 1929 First 7 months	,, ,, ,, ,, ,, ,,	99 7

How do their prices and yields compare with those obtainable on Argentine Internal Credit Bonds?

AVERAGE OF ARGENTINE INTERNAL CREDIT BONDS

(Average of 10 different Series)

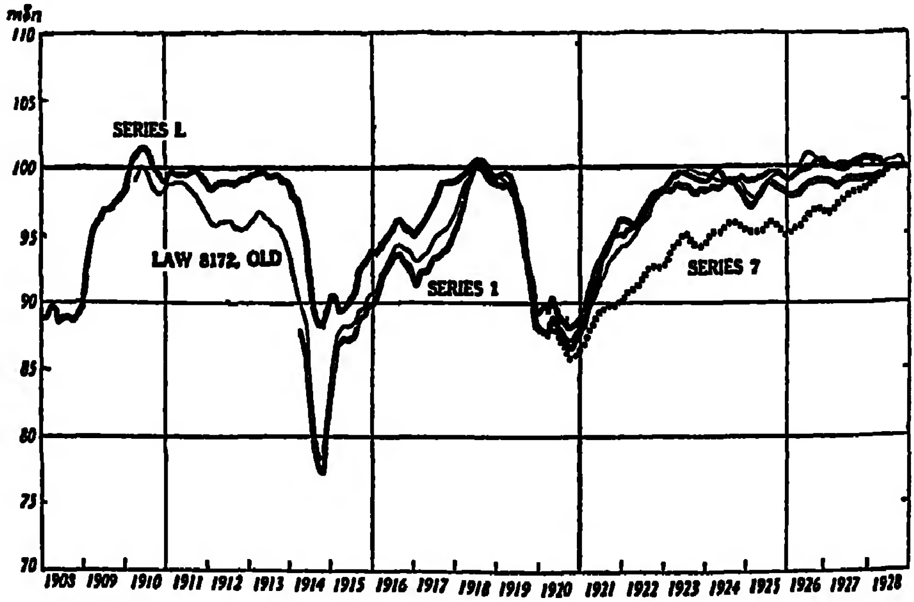
1926	94 78
1927	95 22
1928	98 47
1929	99 03

AVERAGE QUOTATIONS AND YIELDS OF THE NATIONAL CÉDULAS AND ARGENTINE INTERNAL CREDIT BONDS

Average Quotations and Yields in Sept	Series Issued after 1920				
	1926	1927	1928	1929	In Oct, 1929
Quotations (ex coupon)					
Nat Mortgage Ced (29 Series)	97 04	97 89	100 12	99 44	98 50
Céd Arg Int (10 Series)	95 74	95 98	98 81	98 40	97 08
Yields					
Nat Mortgage Céd (29 Series)	6 18	6 13	5 99	6 03	6 09
Céd Arg Int (10 Series)	6 27	6 25	6 07	6 10	6 18

It is clear that in the Argentine the Cédulas gave a lower yield than the internal bonds This indicates that they were regarded as better security We must note that this is exceptional, and applies only to this and a few other classes of mortgage bonds in other countries The explanation is simple The Government guarantee of the Cédula tends to give it the same status as the internal bond, but it has a specific security behind it Added to this, the wide knowledge of Cédulas has made them so popular that they are preferred

It is not necessary to follow the thirty-five series in order to obtain some clear idea of the tendencies in their quotation We will select certain representative series for which we have continuous quotations, which satisfy certain age requirements and are relatively important in numbers The four chosen are known as Series L, first issued in 1907, and the Cédulas of Law, No 8172, in 1909, these two being representative of the old emissions Series 1 and Series 7, first issued in 1914 and 1919 respectively, enter the group of new issues

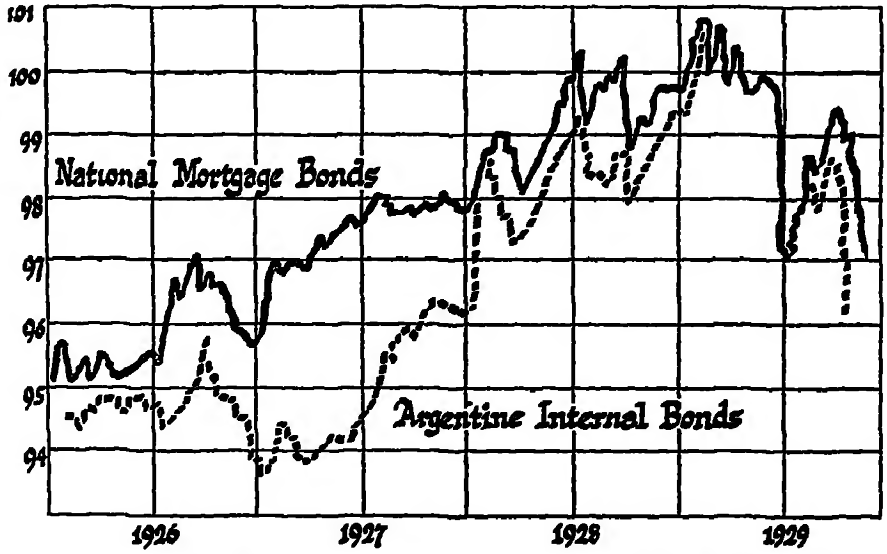


QUOTATIONS OF THE NATIONAL MORTGAGE CÉDULAS
1908–1928

The graph illustrates the quotation of the National Mortgage Cédulas It represents the movement of these four series Between 1907 and 1920 there are two principal cycles, and from that year onward there is an upward movement which, by 1926, takes the Cédulas up to parity During this period there is a rise in value of some 11 per cent in these securities This general trend is very significant when compared with the trend of prices of German or French mortgage bonds In those countries, during the period 1908–1928, there was a comparative decline in the prices of securities The rate of interest had increased The reverse is true in the Argentine The explanation is to be found in the improved credit of that

country Instead of having to pay some 8 per cent for loans on mortgage bonds, she could obtain them at 7 or even at 6 per cent Her credit conditions were, in spite of interruptions, slowly approaching those of the older-established countries

This is best illustrated by the following graph—



STOCK EXCHANGE TRANSACTIONS OF NATIONAL MORTGAGE BONDS AND INTERNAL BONDS

The maximum difference was reached in April, 1927, since when the prices have tended to coincide

Let us now trace the two cycles and see if we can discover any explanation of them The low prices of 1907 and 1908 are characteristic of the prevailing depression Subsequently, quotations begin a rapid ascent and reach their maximum, above parity, towards the middle of 1910, immediately after that a downward movement sets in, which, interrupted by a slight upward tendency in 1912 and 1913, continues till August, 1914 From 1913 the fall is rapid, and becomes more rapid owing to the initial disturbances of the war and the consequent monetary restriction The war aggravated the conditions which produced the downward movement in the Cédulas' cycle During the year 1915, and the first half of 1916, the upward period of the second cycle develops, and, apart from a slight drop back in the second half of 1916, continues until 1918 Quotations then play about parity, which is passed

for a short period, until 1919, when the downward movement commences In 1920, the lowest point of this cycle is reached somewhere round 87 There is a sharp recovery during 1921, and the upward tendency continues until the first part of 1923, when parity is again reached The price then oscillates slightly round parity until the end of 1928 The rates respond rather closely to money market conditions during the whole period

In the last stage it is interesting to study the differences exhibited between the prices of the old and the new Cédulas The quotations of the old Cédulas rise more steeply than the new ones The former approximate to parity between 1923, 1924, and 1925, while the latter oscillate about 95 during the same period In 1926 the old Cédulas rise above parity, and then fluctuate round about parity in 1927 and 1928 The new Cédulas rise in price, and slowly attain parity by the middle of 1928 These disparate movements are attributable mainly to the period they have to run before they are withdrawn from circulation, in accordance with the system of amortization to which they are tied either by purchase in the open market, if the price is below par, or by drawings by lot when quotations stand above parity All the series are repayable at par by a sinking fund of 1 per cent per annum which is cumulative, each series having its own sinking fund which redeems the entire issue in about thirty-three years

The older a series is, the greater is the proportion which the bank must withdraw under the system of amortization adopted Thus the following table shows the percentages of the total circulation of Cédulas in each issue withdrawn during the quinquennium, 1921–1926—

Series L	8 4%
Law 8,172 (Old)	6 5%
Series 1	5 5%
Series 7	4 0%

The bank must, as a rule, go on the market to purchase these bonds This demand is added to the normal investment demand, and tends to drive prices up This influence

is greater as the percentage purchased is greater, and this demand grows intenser as the series grows older Hence the higher quotations for the older Cédulas When, however, the market forces Cédulas over 100, the older the Cédulas the less likelihood is there of them exceeding this amount by much, since the probability of their being withdrawn increases

Here, as elsewhere, in Stock Exchange valuation, prices are affected not only by the fact of amortization, but also by the expectation of amortization They are influenced also by the conditions in the money market, which may be favourable or unfavourable It is extremely significant that even during the later months of 1929 and the earlier months of 1930, when securities—shares and bonds—everywhere declined considerably, Cédulas fell only a point or two Even when the Conversion Office was closed on 16th December, 1929, and further gold exports were prohibited, they maintained their price exceedingly well Two facts help to explain this First, the Cédulas circulate in overwhelming numbers within the country, and so a drop in the foreign exchanges hardly affects them at all Besides, there are few alternative investments of a similar class within the country, and these would be affected by this consideration quite as much Secondly, any substantial drop in price induces those who have mortgaged their property to buy up Cédulas and to cancel their indebtedness This characteristic of the Argentine type of mortgage bond, also common in Europe, tends to prevent the divergence from the redemption price going beyond a certain point

It may be instructive to examine more closely precisely when mortgage Cédulas are issued and withdrawn, when Stock Exchange transactions are most active, and whether we can trace any relationship between these movements and price movements It is noteworthy that during periods of highest prices the emissions are greatest, and during periods of low prices there are only small issues, or none at all Thus a large issue was that of 1912, when the price of Cédulas was high, in 1922 they reached the highest price they have yet known, and that was also the year of the maximum issue of Cédulas 1923

to 1928 were years of substantial issues, when prices were round parity, and 1915, the year when prices were lowest, coincided with the one period when no Cédulas were issued. This is surely no accident, and causal connection can be easily discovered. Clearly, the banks wish to issue their Cédulas at times when they can be most favourably placed on the market. When prices are highest, they can get for the promise of a certain rate of interest a larger amount from the investing public. When they are lowest, they can obtain for the promise of that same rate a small amount from investors. They will therefore seek to make their largest issues when the price of the Cédulas is high. Market conditions are of controlling importance in placing new issues. If the bank can issue its bonds at a low rate of interest, it can grant mortgages at a cheap rate, and this will increase the amount of business it will do.

It is evident that the mortgage bank, in spite of its growing bonded capital and its goodwill, and its attempted control of the price of its bonds, remains strictly subject to market conditions for new capital.

The graph representing Stock Exchange transactions in Cédulas is likely to be influenced a great deal by a large number of extraneous considerations, such as sales owing to panic, the chances of profitable investment in other forms of securities, say in stocks at home or abroad, as well as by the sales resulting from normal investment and amortization. But another significant factor to be considered is the number of dealings on the Stock Exchange engaged in by the ordinary investor. The total of Stock Exchange transactions is influenced very largely by amateurs. It is not to be expected, therefore, that there should be any close and obvious relationship between the price of quotations and the number of Stock Exchange transactions.

The difference between the rates of interest received from the borrower, and the rates allowed to the purchasers of mortgage bonds, constitutes the main source of income of the bank. It may also make profit from its subsidiary activities, and by using its reserves and capital. All its earnings are applied to

the payment of interest on the bonds after the necessary expenses of conducting the business are deducted These include the costs of issue of bonds, the salaries for qualified officials, rent for bank premises, etc , but they are not large Reserves are built up and invested and thereby increase profits Legal provisions in Argentine as well as in other countries, tend to ensure that the surplus will provide ample funds for possible depreciation, this is preferable to a policy of charging the minimum price necessary to cover the market rate, plus administrative expenses, plus insurance against risks

A special reserve fund for contingencies is made up from the following sources—

1 Part of the annual commission charged on each loan

2 Penalties paid by defaulting debtors

3 Funds derived from charges for anticipating payments

4 Principal and interest not claimed by holders of Cédulas

5 The excess of receipts from foreclosure, sales over obligations due from the debtor which are unclaimed

6 Interest on deposits for the account of the bank

The reserve fund may also be lent upon the security of mortgages for five years or less, no single borrower being allowed more than 20,000 pesos

Having discussed mortgage banks and mortgage bonds from the viewpoint of the lender of capital, and then seen how the mortgage bank endeavours to carry on its activities with an eye both to the borrowers' needs and the expectations of the lender, we will now investigate the risks of mortgage lending

CHAPTER VII

RISKS OF MORTGAGE LENDING

LOANS secured on the basis of the mortgage on real estate differ in no fundamental respect from loans secured on the basis of any other security, excepting that there is a greater care in selection within a limited field and in their supervision They will, however, be subject to most of the same risks Individual borrowers may fail through individual deficiencies All borrowers will be influenced by the fluctuations of the trade cycle, many breasting the tides of falling prices well whilst others are being dragged down Whole groups of borrowers may fail if their industry passes through a period of steady decline Why then, it may be asked, has mortgage investment been comparatively safe during the last fifty years? This is not because the borrower always used his loans wisely, but because of the manner in which the bank protected itself against default How is the loan employed?

The investor is not called upon to take the risk of directly extending the productive equipment of agricultural or urban property Rather it is a case of lending on an existing property a percentage of its value, and thus enabling the owner to take the risk of extending his activities The process behind the legal façade may be put simply as follows An owner possesses property valued at, say, £2,000, he pledges the property for £1,000 in order to be able to extend his business to this amount He himself takes the risk of it turning out to be an unprofitable investment The loan on mortgage has enabled him indirectly to undertake further activities If he is successful he will gain the reward, if he fails he loses If fortunate he will enjoy considerable capital appreciation, if unfortunate he may suffer heavily In the latter case he may have to sell his remaining property to meet his obligations The institute which grants the loan on mortgage is secured by the borrower's

original property This device helps to confine risk to where it should belong The undertaker with his special knowledge assumes most of it, whilst the investor, home or foreign, enjoys the safer mortgage bond The owner of the property now has the control of £3,000

But to which business will the borrower direct his loan? If he borrows on his land he may invest the proceeds in its development, or in some other quite unrelated business There is no telling what a man will do with the loan he obtains by mortgaging his house Occasionally some light is thrown on this question Thus, in Sweden in 1926, the total credit extensions of the banks amounted to 4,439,000 kroner, and 41 per cent of this was granted against mortgages It is well known that the Swedish banks undertake a heavy amount of fixed capital financing, and as there are, in addition, first-class institutions for both urban and rural real estate credits, we may presume that a part—perhaps the greater part—of these mortgage loans represent the banks' accommodation to industry In the case of the Russian Nobles' Bank, to jump to a very different type of case, we have evidence to show they used their loans for extravagant expenditure

We may assume, however, that, as a rule, loans on agricultural land are required for expenditure incidental to farming, and loans on industrial property are required for business enterprise There is considerable direct evidence to prove this It is loans on houses that are least certain, but a considerable percentage of this type of loan is given to enable those who would not otherwise be able to do so to purchase their own property by building societies in England, and on the Continent on the security of large apartment houses whose total rental are greater than the interest they must pay Loans on the mortgage of agricultural land may then be anticipated to stimulate the agricultural output, and, similarly, loans on housing to increase the building of houses The sinking of capital by the purchase of bonds based on mortgages in the raw material countries is likely to produce a bias towards falling prices It is to be expected that their loans will be used in

capital expenditure, which is likely to result in a large increase in productivity

Now although these investments have been relatively safe, it is because agriculture has on the whole been a growing industry, whilst urban development has been going on at even greater pace Mortgage investment was sound because the underlying security was on the whole sound, in spite of deficiencies on the part of individual borrowers and the fluctuations of the trade cycle

Certain individual deficiencies are stimulated by this type of instalment credit which is liquidated piecemeal, or in fractions, rather than in a lump sum Like other forms of credit it implies, of course, the transfer of wealth, the expectation of its repayment at a given date, and depends upon the trust or the confidence reposed in the debtor Farmers are thus encouraged to buy with its aid, and extend their farms High-power salesmanship stimulates urban dwellers to buy or build houses During periods of prosperity both lenders and borrowers welcome this expansion of mortgage credits An optimistic mood drives both to wide commitments In agriculture, production by small units is common to an unusual degree A high proportion of persons are working on their own account In England it is one-third in agriculture as compared with one-tenth of all industry, whilst in countries where peasant proprietorship prevails the disparity is, as a rule, greater When agricultural products yield good prices there is a general demand from tens of thousands of borrowers for credit facilities Similarly, if house rentals rise, say, 10 per cent, there is a disproportionate increase in the demand for building loans This device for credit expansion has as its shadow side the creation of debt A growing community can have a steadily mounting fund of debt But it cannot continue growing disproportionately to the wealth of the country On the one hand lenders become shy The supply is decreased There is a limit to their saving and their investing power On the other hand, borrowers, too, begin to reflect that their loans involve mortgaging their future incomes The more cautious realize

that they must reduce their scale of living The less cautious are forced to it as soon as conditions make it difficult to meet interest and amortization charges The danger is that people will mortgage their future too heavily and for too long a period They will be tempted to pyramid loan on loan, instead of liquidating their past before mortgaging their future any further Either they will collapse in their effort to make good their commitments and thus be sold out, or they will be saving at too heavy a rate and suffer by their present low standard of living The misery of mortgage will become a reality to many

The trade cycle reveals the weak borrower During periods of falling prices many of them are unable to meet their obligations This may be illustrated very strikingly from conditions in the U S A during the decade 1920–1929 The amounts lent on mortgages by land banks and much more on urban real estate by commercial banks, mutual savings banks, life insurance companies, building and loan associations, and by private investors during this period was, indeed, unprecedented

The twelve Federal Land Banks showed an increase of total

HOLDINGS OF URBAN REAL ESTATE MORTGAGES[1]
(In Million Dollars)

	Commercial Banks	Mortgage Bonds	Mutual Savings Banks	Life Insurance Companies	Banking and Loan Associatns	Total
1920	(3,000)	[2]500 0	(4,000)	1,252	2,318[3]	11070 0
1921	(3,000)	529 5	(4,125)	1,443	2,659	11756 5
1922	(3,393)	681 5	(4,250)	1,634	3,065	13023 5
1923	(2,674)	899 5	(4,375)	1,825	3,627	13403 5
1924	(3,449)	1190 0	(4,500)	2,019	4,384	15542 0
1925	(4,221)	1883 1	(4,025)	2,507	5,085	18321 1
1926	(4,993)	2654 1	(4,750)	3,153	5,827	21377 1
1927	(5,767)	3304 6	(4,875)	3,701	6,583	24230 6
1928	(6,221)	3972 4	(5,000)	4,290	7,336	26819 4
1929	(5,195)	4168 9	(5,125)	4,831	7,787	27106 9

[1] Prof Charles E Persons has constructed the above table *Quarterly Journal of Economics*, Nov 1930, p 104

[2] Bracketed figures interpolated or estimated

[3] 92% of total assets This is based on statements of percentage mortgage loans and total assets for the years 1925 to 1928 inclusive

mortgage loans outstanding from 156 million dollars in 1918 to 1,198 million dollars in 1929, and the Joint-stock Land Banks from 8 million dollars in the former year to 627 million dollars in the latter

Loans were thus increased from 11 to 27 billion dollars, nearly 150 per cent in 10 years The period of most rapid increase was in the three years 1925, 1926, and 1927, when 9 billions of increase in new urban real estate debt was incurred, an amount almost equal to the total indebtedness in 1920

Is there any danger in a credit situation of this kind to the banking structure?

Investment bankers who sell mortgage bonds seek the assistance of the commercial banks for the purpose of obtaining advances They will, if necessary, deposit the unsold bonds of an issue as collateral, and on these a high percentage of their market value, some 80 or 90 per cent, will be borrowed Their own capital is not adequate, so they supplement it by a much larger volume of loans from the banks The securities' broker in America and in certain other countries will also grant loans on collateral, and, of course, the individual investor will be able to obtain such facilities from his bank During normal times and during business revival such aid is regarded as legitimate, and neither investment houses nor brokers nor banks run into difficulties because of it Whilst prices are rising speculators and investors use their profits to support further purchases, but when the decline in stocks sets in speculative margins are impaired and holders are obliged to throw their holdings overboard As liquidation develops, prices fall very fast Panic conditions soon follow Commercial banks, investment banks, and brokers are very cautious with loans, there is a general "freezing" of the credit situation, and call money rates are high From a period of over-investment we come to a period of under-investment If we examine more closely what has occurred, we find that the commercial banks have allowed their liquid funds to be drained off and to be used as capital Investment has taken place in capital goods which

are constructed with the borrowed funds If investment of new savings takes place, then no strain on the banking situation is likely to develop, but it may very well mean that investment has outrun savings for a time If the total invested in this form of loan comes from the savings and surplus capital of individuals and companies, it will mean that a greater proportion will be diverted to this purpose than is desirable, for other industries will then have too little But saving may be less than borrowing, and then the banker may by lending his deposits encourage too much to go into the production of capital goods, and too little into that of consumption goods Periods of boom are periods of great building activity, and periods of depression are periods of greatly lessened activity in the building trades

Carnegie used to say "The steel business is either a prince or a pauper" The railway industry in America also grew by a series of jumps, there was over-extended railroad construction for two years in the nineties, and then halt for a year The construction of houses and the increase of farm investments also follow the rhythm of activities known as the trade cycle, and, unfortunately, share both stages of over-development and under-development characteristic of all trades It is not to be forgotten also that the last ten years have been characterized by very fundamental structural changes which have aggravated the effects of the trade cycle

But, it might be argued with justice, there is nothing unusual in all this It is characteristic of all industries during the boom period There was, however, one special additional feature in this development in the United States during that period The device of the mortgage bond was comparatively new A real financial adjustment took place A very marked increase in the amounts was made available for this purpose From a state of comparative under-development in mortgage loans, a state of over-development was soon attained The device reached maturity and was forced beyond that by the pervading optimism The building industries were stimulated to expand their productive capacity, and labour flowed into

them at an abnormal rate When the stop came the readjustments—the falls in real estate values, in prices of materials, wages, rates of interest, all produced a grave dislocation

The picture presented by the balance sheet of a newly established mortgage bank system is apt to be misleading, and to give an exaggerated impression of the business done Loans previously carried by commercial banks are now provided by the mortgage banks Short period loans especially are lessened, and in their place long period loans are taken up, whilst loans at high rates are converted into loans at low rates But after allowance is made for this, it is possible for a newly established mortgage bank system to make for a too rapid expansion of credit in its early years

Two conclusions emerge from American experience There is need during periods of booming trade to consider the healthy limits to this type of credit expansion Over-investment in the industries and undertakings served by mortgage bonds will be followed by depression The greater the expansion the more serious will be the decline when the boom ends and the slower the recovery In this, as in other parts of the economic world, a steady flow of capital giving an even development of the business should be the object sought There is evident, also, a special danger to be guarded against in the early period of the introduction of the new device The possibility of over rapid expansion may not always exist, but where it does it should be avoided

The experience of countries with long established mortgage banks has helped them to avoid these particular dangers Moreover, there is relatively more interest in the purchase of shares rather than of bonds during the boom period This tends, as a rule, to slow down the pace of mortgage loans during the peak of the boom, whilst, on the other hand, it tends to increase the pace during the most depressed period and before the general recovery

Is it possible to pursue a systematic policy which will tend to lessen these fluctuations? The most potent influence which could be brought to bear on the amount of production would

result from the rate of interest A rise would tend to lessen the flow of capital into these channels, and a decline to increase it But we find that the great bulk of loans on real estate in all countries is made at more or less stable rates of interest It is profitable for the average borrower to borrow at a fairly definite rate The influence to which he is subject, owing to fluctuations in prices of raw materials and farm products, or owing to the varying demand for durable property, expose him to the full effects of economic blizzards But he is expected to foresee these and to allow for them in the long period rates he pays for loans Therefore there is least variability in the interest rates on long term mortgages and bonds, less than in any other series of interest rates Another consideration emerges when we consider relative amounts invested Since there is a much larger amount lent in long term than in short term loans, there is less variability in the former than in the latter Thus, although the rates of interest on mortgages and on mortgage bonds vary from country to country and from province to province, the rates change slowly and within relatively narrow limits over a series of years, and show little cyclical fluctuation

If during a depression the rates of loans on mortgages and mortgage bonds were forced down to a very low level, then borrowing and production could be stimulated But how achieve this? The long term rate and the amount of investing is not easily influenced by the banks A Government subsidy for a limited period might be made to achieve it, but then this is only another form of the protean proposal for "ironing out the trade cycle"[1]

It may be argued that these conclusions are the offspring of a fatalistic attitude towards the trade cycle This is not, however, altogether justified It would be even more dangerous to contend that we should cease our investigations into the methods of making industry more efficient in technique, organization, and provision of capital and risk-bearing until

[1] We shall see in the next chapter that the International Mortgage Bank might encourage this policy to a slight extent

we know how to integrate national with world industry as a whole, to plan production and to eliminate trade fluctuations. In this study we are concerned primarily with the former task

The third cause of failure on the part of a borrower would result from the decline of the industries affected, agricultural and urban development These stand on a very different footing from one another *inter alia*, since a decline in one may be accompanied by an acceleration of growth of the other The threat to agriculture to-day comes from over-production or, as it is frequently put, from a lack of purchasing power by the importing countries Great structural changes are taking place, and some contend that it is undergoing a transformation parallel with that which industry went through at the beginning of the nineteenth century Improved technique and the diminishing growth of population involves that a lessened proportion of the world's population will be needed to supply the world with food, and it may be that whole areas now engaged in agriculture will be abandoned As it is the food grower has, in nearly all countries, a lower standard of living than the industrial worker Judged by this test, are we not already overproducing farm products?

The long period of production and the large numbers of farmers mean that it is very difficult to adjust supply to demand, and in particular to cartelize farm products Hence the farmer buys in a monopolistic market, and may sell in a competitive one or be confronted by a monopolistic merchant syndicate, unless he himself joins a farmers' selling organization

The criticism of those who oppose the grant of loans on the basis of agricultural real estate is directed against the investment of further resources in an industry whose outlook is uncertain There is a growing tendency, therefore, to view problems of farming less from the angle of the individual farmer, and more from the angle of the industry as a whole in each country, and to regard the questions of marketing as more fundamental than questions of production

The proposed organization for standardizing products and establishing unified machinery for exporting and selling their products by the agrarian countries of East and Central Europe illustrate the force of the change The selling organization must control the production, and the question is raised, should not then loans, too, be associated with the marketing organization? Would it not be in a position to provide loans for farmers and direct them into a field of activity where their efforts will be more profitable? It is true that some farmers may foresee the future wisely, like the large farmers in Hungary who in recent years have diminished their cultivation of wheat, and concentrated their efforts on live stock for export But the farmer is not in a position to make an intelligent forecast as to the future world needs for his product It is a task for a well-equipped statistical body

The mortgage bank must discover in the first place whether the whole industry requires more capital before judging whether the individual applicant for loans is efficient and reliable, and whether he can be trusted to use his capital safely and profitably There is a wide fear that in a quickly changing world the limited outlook of the farmer and his constant passion for acquiring more land may encourage uneconomic expansion Why is there this tendency for the farmer to acquire more land than his labour and machinery warrant? It is due in part to the wide prevalence of social prestige attaching to land ownership Again, it is difficult frequently to obtain nearby land precisely when it is wanted It is therefore purchased when it is available, even if it is not desirable to acquire it at that moment Moreover, the attitude towards saving differs from that of the townsman, in part because the farmer may be a bad business man He is not prepared to calculate exactly whether it would pay him to leave his savings in the bank rather than own another piece of land, nor whether to keep his savings as a reserve against bad times as the manufacturer does Unlike the townsman who is afraid to make investments outside of his own business without professional advice and knows the limits to the absorptive capacity of his own

business for capital, the farmer is always ready to purchase land Provided that facilities exist the farmer will exploit them But the great speeding up of transportation and the revolution in agricultural science has made this dangerous for the individual farmer This is particularly so in the case of European agriculturists because costs of production in the overseas countries are far lower than their own

Holland, Scandinavia, and, to a lesser extent, Switzerland have adjusted themselves to these facts But other countries seem determined to maintain their peasant agriculture at all costs with their staple products—wheat and sugar For this purpose they have adopted tariffs, quota systems, either singly or in combination, and in some countries State purchase boards These devices are treated as substitutes for boldly facing the task of adjusting production to the changing demands of the world

The consuming markets are likely to require more meat and bacon, more eggs, butter, and milk, more fruit and vegetables, perhaps more wool, cotton, silk, and oil seeds Agriculturists must make the inevitable changes and readjustments With Russia at their doors adopting all the improvements of mechanics, it is clear that a policy of restricted output in Europe and overseas will not gain its purpose

Only when European agricultural conditions are again healthy will securities based on it constitute first-class investments

Whilst, then, any further investment in agriculture calls for very careful investigation and the desirability of caution during a period of revolutionary changes, urban development is in a healthy and flourishing condition In the progressive countries the standard of household accommodation is being greatly improved and similarly with business premises The growing proportion of the population which lives in the towns, the comparative ease with which property can be let, the shortage resulting from the War, are all making for the soundness of this type of investment But the eagerness to discount future rises in value in various areas leads to an undue

inflation of property prices, and this is fraught with dangers of its own Nor should it be ignored that with the decline in population the former steady rise in price of urban and rural land will be reversed

Mortgage bank directors will be influenced by these considerations They will avoid lending too much in the early period of the establishment of a new bank, and during periods of boom they will try to foresee and provide for the welfare of their industries as wholes. Only then will they be able to protect the individual borrower from his own wish to pursue a policy based on a limited knowledge of the facts

CHAPTER VIII

TENDENCIES THE INTERNATIONAL MORTGAGE BANK

THE demand for long term credits secured on real estate is widespread It is common to the U S A, Great Britain, and Norway, as well as to Germany, East Europe, and South America, i e to the lending as well as to the borrowing countries

The increase in the need for long term real estate credit, and the advantages of mortgage bonds as the means of supplying it, have resulted in the growth of a considerable number of new mortgage banks in recent years Ignoring altogether the interesting and important Federal Farm Loan Board of America, we find that such banks, or some similar organizations, are being introduced even in the older countries where they did not previously exist, such as in Great Britain[1] Where historical and legal obstructions are not in the way, they are introduced as a matter of course as the most rational way of providing capital for real estate purposes In Rumania, Yugoslavia, Bulgaria, Poland, and Greece, in the Border States, and in Palestine, mortgage banks have been recently started Other countries, such as Turkey, are taking preliminary measures for their introduction At the same time, countries with mortgage institutes are raising new loans through a series of new issues It is clear that this form of business has grown very rapidly in recent years Moreover, there are strong indications that as soon as the capital market permits there will be even increased activity along these lines

Although the mortgage institute had its origin in the necessity for providing agricultural credits on reasonable terms, there is a constant tendency for it to devote attention increasingly to urban real estate This is proved by the large number

[1] Great Britain issues debentures through a special mortgage corporation (See Chapter XII) Its functions and method of work are based, however, on those of the mortgage bank

of joint-stock companies which have developed, and which devote themselves exclusively to town property, and also by the manner in which even organizations like the Crédit Foncier, founded in order to aid agriculture, now grant twenty times more loans on city than on rural property

The increasing tendency to concentrate on urban, and to reduce loans on agricultural property, is due to the almost world-wide agricultural crisis The substantial decline in the prices of products has impoverished the small farmer At the same time, those who borrowed money at 8 or 12 per cent must continue their payments The average peasant income is estimated to have fallen over 20 per cent Such conditions make for a steep decline in the value of the land, and they are characteristic for Central Europe, for Poland, Czechoslovakia, Hungary, Germany, Yugoslavia, and *mutatis mutandis* for all agricultural countries The small peasants on the newly-divided estates are the least able to stand the crisis They are unable to meet their obligations to their creditors, and thus tend to fall into the grip of the banks The mortgage banks require great patience and skill to deal with this situation It is almost as difficult to lend on declining securities as it is to deal in them There is less trouble and administrative expense in urban loans A better distribution of risks is possible Urban property can, as a rule, be more quickly sold There is only one satisfactory way of countering this excessive tendency to concentrate on urban loans Institutes can be limited by their statutes and organization to agricultural property only, as is done in the case of the recent British scheme, or they may be obliged to use a fixed proportion of their resources for this purpose But mortgage banks seem to be growing not only in numbers, but in influence They are extending their scope Owing to the need for raising capital the methods of the mortgage bank are being applied to industry The industrial mortgage bank had considerable opposition to contend with

Another post-war tendency is the development of the national or centralized mortgage bond There was at one time

a struggle between the local small issue of bonds bought by people in a circumscribed area close to the mortgaged property, and the national issue of standard bonds held by investors and secured by property in all parts of the country The second type, based on the Swedish experience, has tended to become more prevalent The element of security in mortgage bonds being naturally strong, marketability became the deciding factor Clearly, a big mortgage bank with a substantial amount of capital, and with well-known directors issuing a large number of bonds based on the security of different types of property in all parts of the country, was likely to have a better market than those of a small bank Its bonds enjoyed the advantage of being acceptable to the investor, and, therefore, the bank was able to increase its issue of bonds The local institute still grants the loans, whilst a central body issues bonds The two functions are thus separated

The Deutsche Rentenbank-Kreditanstalt, founded in 1925 as a public institution under Government supervision, is based on the Swedish model Its object is the provision of agrarian credit to existing mortgage institutes through a central agency The main administrative body, the board, consists of 110 members representing the most important agricultural organization of Germany

France with its Crédit Foncier, which has a virtual monopoly, and Sweden with its centralized system, have placed large issues on the market, at a rate of interest less than the countries with comparable conditions where small banks have made numerous issues The comparison is not conclusive because other elements enter, but there is a strong presumption that this monopoly of borrowing power through mortgage bonds has made some of the difference Another effect of a central issuing institute has been to tend to equalize the rate of interest over the whole country, allowance being made for any special element of risk and for administrative expenses But the main purpose in this device is to improve the marketability of bonds, and the building up of a larger capital basis

The tendency towards the development of the centralized mortgage bond may be viewed as part of a related tendency, viz the growth of the amalgamation movement—the merging of isolated mortgage banks into groups Sometimes there is complete fusion, or the formation of a central bank for like institutes, but more frequently there are agreements as to price of issue, rates of interest, time of issue of new bonds, etc

The tendency towards this form of rationalization may be best illustrated by examining the recent history of German mortgage bonds, although it has been attempted also in the U S A

The concentration movement so marked in the case of the joint-stock credit banks has thus been paralleled in the recent history of the mortgage institutes Fusions do occur, but with difficulty, owing to the legal obstacles which result from the fact that a fusion ends the independent existence of the amalgamating institutions, and then the holders of mortgage bonds are entitled to claim immediate re-payment In spite of this fact, quite recently, in 1929, the Preussische Hypotheken Aktien Bank fused with the Preussische Pfandbrief Bank,[1] and this, in turn, fused with the Preussische Central Bodenkredit Anstalt, and the new name is the Preussische Centralbordenund Pfandbrief Bank

The tendency for the mortgage institutions of Germany to form themselves into closer units is seen in the formation of Zentrallandschaften—central banking institutes But it is revealed most clearly by the fact that eight of the oldest mortgage banks combined after the war to form the Gemeinschaftsgruppe Deutscher Hypotheken Banken to last at least forty years They have an aggregate share capital of 40 per cent of all the purely mortgage banks in the country Objects common to all of them are promoted through the centralization of their resources Profits and losses are pooled in proportion to their share capital, so that, in effect, the liabilities of these banks are secured by their combined capital

[1] The capital of this bank, amounting to 12,000,000 marks, is held in part by Ivar Kreuger, who is also on the directorates of some of the Swedish mortgage banks and of the Internationale Bodenkreditbank at Basel

About half the joint-stock mortgage institutes are associated in the following three groups, whilst their activities cover substantially more than half of the total trade carried on—

ASSOCIATIONS OF MORTGAGE BANKS, 1929[1]

Name of Group	No of Institutions	Share Capital		Reserves		Mortgage Bonds Outstanding	
		(In Millions)					
		1913	1929	1913	1929	1913	1929
Gemeinschaftsgruppe Deutscher Hypothekenbanken	8	146	55	46	15	2,358	531
Gruppe Preussische Centralboden	4	95	35	27	10	1,841	360
Süddeutsche Gruppe	5	108	33	71	11	2,225	216

Advocates of this concentration movement have argued that the foreign investor might be interested in a national issue secured by widespread mortgages, although he would not be prepared to invest in locally secured bonds

The issue of large loans would be possible, it was thought, if competition were modified amongst the banks by agreement as to the conditions upon which they were each to issue similar types of bonds on the market Money could be borrowed more cheaply A better distribution of risks would be effected A cheapening of administration was also anticipated The reductions in the amount of capital reserves, etc, is accounted for in part by the effects of inflation and stabilization, and stimulated the amalgamation tendency

Now whilst marketability has been the object most sought, concentration was a device which promoted security also The wider and more varied the cover, the greater the safety Indeed, insurance companies impressed with the smallness of

[1] See Chapter IX on Germany for recent amalgamations

the risk are now prepared to guarantee the due payment of interest Certainly, it now appears that the insurance companies in certain countries will be increasingly ready to assume the risk of guaranteeing payment of interest and of capital when it falls due This responsibility has already been assumed in America by surety companies

In the same way, as at the Genoa Conference of the League of Nations in 1922, recommendations were made for the establishment, by each of the newly-created States of Europe, of a central bank, standing in close relationship to the government of the countries in which it was located, so now it is frequently contended there should be established a central mortgage bank in most countries which need long period loans

Clearly, the same technical changes which operate to produce large scale banks with their numerous branches are operating in the case of mortgage bank business The quickened methods of communication and transportation, the telephone, the mails, motor and air services, have made possible direct supervision by the head office, and the constant working together of branches over a wide area The independent bank can be easily replaced by a branch, and economies will result It should, however, be noted that one factor making for concentration in deposit banking, the increase in combines, cartels, trusts, etc , does not affect this branch of banking to any extent

The usual objections to concentration have been raised Increased bureaucracy, the loss of local interest, and the undue power to control the development of whole areas are some of the grounds of complaint

We may summarize recent developments in the following manner Mortgage banking is tending, in all countries, to create a central organization for itself The size of the individual bank is increasing, and the system of branch banking generally in a modified form, which had perhaps better be called agency banking, is being extended

The various Governments are monopolizing these activities, or at least favouring central banks through subsidy or special

privileges The fact that capital is difficult to obtain in the world markets strengthens the tendency towards Government intervention and social control Here, as in other branches of banking, there is a drift towards the establishment of a few banks with large resources

In spite of the considerable growth of interest in mortgage bonds the position remains, as we have seen, unsatisfactory There exists a large unsatisfied demand for loans, and, at the same time, the rate asked for in a number of countries is so high that it is helping to ruin certain types of borrowers The question persists, therefore, how to perfect the machinery for obtaining more capital How make a larger quantity of mortgage bonds fully marketable?

Perhaps the greatest single obstacle to foreign loans of all kinds is the fear of currency inflation To meet this the Chile Mortgage Bank lends to the farmers on condition that they repay in terms of a currency which has not been inflated Hungarian and Italian mortgage banks undertake to repay their loans in the foreign currency lent to them, whilst a Bill is now before the Reichstag to make it lawful to contract to pay mortgage loans in foreign currency It has been suggested that it may be possible to insure against currency fluctuations [1]

A passive or an active policy may be advocated for the immediate future Those who favour the former may point to the fact that mortgage banks are likely to become, if not interfered with, a steadily growing market After the war there was, for a period, a greatly diminished interest in this form of security, but it revived as economic conditions grew calmer This is markedly the case in Germany Time must be allowed for the shifting of the central markets to be completed Prior to the War, France, Germany, and Holland were the centres for mortgage bond investment France remains stronger than ever as a feeder for long term capital investment The United States has become the largest capital centre, whilst Germany has become the largest borrower Great Britain is gradually taking some interest in these

[1] See Appendix III

bonds, whilst Holland remains practically unchanged as a centre for the issue of foreign mortgage loans, and Switzerland has increased her activity in this field in recent years For the next decade we may expect both a shift of investment in these securities from the Continent of Europe to the more Western countries, and at the same time an increase in the amount invested It is anticipated, also, that when small investors learn of the growing tendency for professional investors, insurance and trust companies, savings banks, etc, to invest in this type of security, that they, too, will go in for it more

That this will be too slow a process is the view of those who favour an active policy They hold that these banks can and should exert a certain amount of general control over capital investment, and can and should dictate the terms of loans raised They point to the great increase in the demand for capital abroad from those countries impoverished by the war as a large factor added to those operating previously Three methods of stimulating interest are advocated. standardizing the legal framework of mortgage bonds, Government ownership or control, or subsidy for mortgage banks, and the institution of an international mortgage institute

It would be clearly advantageous if the rules laid down for supervising the German mortgage institutes were adopted by other countries A proper *cadastre* is necessary The *grundbuch* should be introduced Antiquated legislation should be abolished Poland still has three systems of mortgage legislation prevailing in different parts of the country, and Lithuania five—one dating back to the days of the Hanseatic League A standard law, or, at least, certain standard minimum requirements adopted in each mortgage law, would tend to produce greater confidence in this security Such an arrangement would lessen the necessity for a careful investigation into the legal position of mortgage bonds in every country wishing to sell its securities of this class Amongst the points which should be settled is the tax status of these bonds. Modifications of law and practice in this particular

are regarded by some as the essential foundation for extended foreign investment

The other measures advocated are of a more radical kind, and might produce an even more substantial result

In these days it would be impossible, in any study of the future of banking, commerce, or of industry, to ignore the demand for the assumption by Governments of the administration of economic institutions In the impoverished countries, Governments are being driven to extend their economic activities The tendency clearly manifested since the War toward the active supervision of central banks by the Government has spread also to other branches of banking The examples of the Federal Reserve System and of the Bank of England have been specially potent in impressing many with the view that mortgage banking, too, should not be allowed to return to purely private control seeking primarily individual profit In the newer countries a national mortgage bank is usual Even in the wealthier countries such an institution is regarded as properly coming within the scope of Government action

Everywhere there is the desire to create instruments which will facilitate Government borrowing as well as long term private borrowing We cannot, therefore, ignore the fact that mortgage banks are generally regarded in all socialistic programmes as being ripe for Government assumption, although nowhere is there for the moment any active demand for such a step But Government guarantees, Government subsidies, Government loans are constantly urged

The argument in favour of nationalization is many-sided These banks are subjected to supervision, they are forced to give a great deal of information as to their activities, they ask to have their bonds exempted from taxation and recognized as trustee securities, and, in brief, rely on Government aid in all difficulties and crises It is asked—is it reasonable that private profit-making companies should know that they are able in an extremity, whether caused by public policy or business misadventure, to summon the resources of

the State to save them from disaster? Others insist on the special nature of agriculture and house building They argue that to leave entirely to private business enterprise the supply of capital to these basic industries with occasional inroads of State intervention at moments of peril is a course as indefensible in reason as it is injurious in practice It is contended, also, that if these organizations, which are already regarded as quasi-public, were to become entirely public that they would be used more

The return on mortgage bonds, the argument runs, is in many countries about 1 per cent higher than on Government bonds The under-valuation of the security of the mortgage bond excepting where, as in the Argentine, it is issued by a Government bank, results in a large interest having to be paid for loans This leads to a smaller demand for capital for these purposes than would be the case if the rate of interest were lower The assumption by the State of this business would give it the advantage of the higher credit usually enjoyed by Governments, so that lower rates would need to be paid for loans Consequently, real estate would obtain its loans more cheaply, and the amount of this type of business would be greatly increased

Advocates of nationalization maintain that on the technical side the work is easy, a large part of the business being ascertained and automatic The administrative body works on agreed lines in a rather standardized manner It would make little difference whether the bank were run by the State or by a private company Besides, there is comparatively little risk Not much capital is required A monopoly on a national scale by compelling further diversification would lessen risks

The central difficulty results from the fear of political influence of an unhealthy kind Would certain districts be given a preference? Would towns enjoy greater advantages than the country? In brief, would it be possible to maintain sound banking principles? Besides, it may be argued that once existing shareholders must be compensated with other Government securities, there would be little gain from civil service

administration as such. Concentration undertaken voluntarily by the private joint-stock companies will produce as great an economy as the substitution for the existing joint-stock companies of a nationalized system of mortgage banks. Moreover, there is the very real fact that many are opposed to nationalization. The fear of a boycott, or even the threat of a boycott of such banks, must be accepted as an argument against this policy. These objections do not apply to the more usual State subsidies. They are very common in the case of mortgage banks serving the needs of agricultural borrowers. When considering world farming as distinct from national farming, such subsidies as part of a system of protection which resorts to tariffs, prohibitions, and quotas are being increasingly questioned. The subsidy to stimulate output may, indeed, be very objectionable. The same device is, however, beginning to be used to lessen output or to change its nature. It is granted on condition that lessened acreage is planted.

There is a more novel proposal which deserves consideration, and which is also paralleled in other branches of banking. Many unwilling to lend to Governments or industrial companies would be willing to lend on this type of security. It is suggested that an international mortgage bank might be established for the direction and distribution of international capital in this field. Indeed, it is argued that this is the logical and proper outcome of recent tendencies. The bonds of such a bank based on diversified securities should supplement the existing machinery for mortgage bond issue. An international bond well secured might very well solve the two problems of making these bonds marketable, and making them marketable at a low rate. They could be made into a world security purchasable in all markets. This bank could be to the mortgage banks of the world what the Swedish Agricultural and Urban Mortgage Banks are to their local banks. Like these banks, it would lend its money to existing mortgage banks who would find it more difficult to raise funds for themselves on the markets of the world. Different rates could be charged to the banks who wish to borrow according

to their credit But it could lend on the security of specific parcels of property, as well as on the general security of the borrowing bank The international bank would need some machinery for examining the security offered, but this would not be elaborate since it could rely, in a measure, on the judgment of the borrowing bank which gives its additional pledge At the same time, the danger from the political factor, so large an element in influencing the security of bonds, would be greatly lessened

On the basis of these mortgaged properties, the international bank could issue a standardized bond of unusual stability and strength giving, a definite specific yield The security consisting of mortgages in different areas of the globe, in a number of countries, and relating to landed and urban property, would be extremely well diversified The rate of interest offered need not be too high, say 5½ or 6 per cent It would, in time, come to be regarded as one of the most secure and stable investments in the world

Let us endeavour to see this proposal in a concrete form Supposing the international mortgage bank is founded with a capital of £5,000,000 [1] It would gradually grant loans to that amount on properties in a number of countries mortgaged with it Let us suppose that they are situated in Germany, Yugoslavia, Egypt, Argentine, and Brazil Agricultural properties, as well as business and residential properties, would be included On the basis of this mortgaged property the bank could then issue bonds to the value of £5,000,000 With this fresh sum it could grant further loans Thus, on the basis of £5,000,000 capital, an amount equal to £50,000,000 could be lent

The administrators of the bank will find that they obtain higher rates for their loans in certain countries than in others But in order to have a well-balanced group of holdings, they will prefer to invest a portion of their resources in areas where

[1] Such a bank really requires very little capital Like the Commonwealth Bank of Australia, it might start with a guarantee and have no capital at all But City people are conservative as a rule, and it will be wiser to found the bank on the model of existing mortgage institutes

the risk is relatively low, as well as in areas where it may be considered high The bank would resemble in this respect an investment trust or holding company, which mixes its securities and is controlled by specialized investors It would, like them, tend to overcome the obstacles to the free movement of capital, the prejudice in favour of certain customary investments, the cost of movement, and imperfections of knowledge

The prospective advantages of such a bank may be summarized briefly—

There will be a systematic survey of the needs of different localities and industries in each country

The policy of the mortgage banks of the borrowing countries and of the issuing houses who act for them would become more methodical

The present scramble for loans would be stopped, and the best distribution of resources between competing markets would be effected

The mortgage banking system within each country, its law, its banking organization, would be improved and organized with the object of providing the best security for foreign loans

The laying down of the minimum conditions to be satisfied for the grant of loans would strengthen the mortgage bank structure in many countries

The issue of bonds by a powerful international mortgage bank ought to enable it to borrow at a cheap rate, and to lend to the borrowing banks at rates lower than they must pay when appealing directly and separately to the public

The bonds issued will have the advantage of offering a better security, because widely distributed, and better marketability, because it will be sold in the lending and borrowing countries, and will consist of comparatively large issues

It provides a security which will always be available to give the general investor a definite fixed income

Syndicates which organize the issue of loans have frequently used them as instruments for gaining concessions unrelated to those loans They have been used to give the syndicate

control of some of the economic forces of a growing region Nor has it been rare for loans to be influenced by Government sympathies or antipathies and thus to serve political purposes Investment in mortgage loans has not always been based on pure financial calculations, although they have been less influenced by these outside influences than any other type of investment, whilst an International Bank would be still less influenced by them

Should such international mortgage banks be organized as private profit-making organizations, or should they be organized on a non-profit basis, and run, perhaps, by some such body as the Economic Council of the League of Nations, the International Institute of Rome, or the Bank for International Settlements?

A profit-making organization could begin its operations much more quickly, it could, doubtless, achieve satisfactory business relations with existing mortgage banks easily, it would be relatively free from political pressure, and could, therefore, lend or withhold from loans on purely business grounds The non-profit making or public bank would be an international instrument, and subject from the outset to constant political pressure But its one great advantage would be steady concentration on the object of reducing the rate of interest On the other hand, borrowing countries would resent conditions laid down for guaranteeing loans as interferences with their sovereignty if attempted by some public body A commercial company would be more powerful in bringing pressure to bear on the borrowing countries

What are the rights of the man who buys mortgage bonds in such an international bank? If he buys those of a national bank he immediately acquires an interest in a security, which, as we have seen, is protected by special legislation against the bank and against its debtors Such an international bank would have its headquarters in Geneva, Amsterdam, London, or Paris, and would be subject to the laws of the country of its domicile It would be possible to confer on the international bond the same type of privileges as distinguish the national

mortgage bond This would necessitate, however, that each country should pass a specific law giving it the same rights with respect to execution as is possessed by the national mortgage bonds, and, at the same time, an international agreement could be made to control and govern the activities of the bank The League of Nations, by its proposal of a standardized mortgage law, has taken the first step towards facilitating such international agreement But it may be doubted whether such a complicated development is necessary It would be sufficient if the bondholder had the usual legal rights against the international mortgage bank possessed by any debtor against a corporation in the same country Some outside body like the Bank for International Settlements could act as trustee The business of the bank under normal conditions would be so safe that, provided the usual precautions are taken, no special privileges are called for The international bank could lend to the borrowing bank an amount against the security of its mortgage bonds covered, perhaps, by specified mortgages held for it, as well as by the general security of the bank It, in turn, could issue its own bonds against this security to an amount equal to what it lent If any borrower defaulted, the local bank would have to act against the debtor The ultimate security in every case would thus be the local bank

There is nothing about the nature of the mortgage bank which necessitates that all the long period international investments secured on real estate mortgages should pass through one investment bank The Bank for International Settlements, the nucleus of a world central bank, which is to do for the commercial banking of the world what the central banks do for each country, would be hindered if its activities were attempted by two competing organizations One central bank for controlling the flow of gold and of short term money is adequate, and two opposing banks would prevent its object being effected We have already seen why it is necessary for there to be a special or central national mortgage bank for agriculture in each country The non-specialized mortgage bank finds it more remunerative to invest in urban mortgages

The same reason will operate to justify the founding of a special International Agricultural Mortgage Bank There could be certainly a number of international mortgage banks both for urban and agricultural credits In recent months the Compagnie Centrale pour Prêts Hypothécaires was founded in Amsterdam, and the Internationale Bodenkreditbank at Basel, and the International Institute for Agricultural Credits has been projected [1]

The Institut Central pour Prêts Hypothécaires was registered in December, 1930, with headquarters in Amsterdam by a body of the leading bankers in different countries It has a registered capital of 10,000,000 florins, of which 1,000,000 florins are issued and 250,000 florins actually paid up It is a question whether the issued or paid-up capital should be regarded as the basis on which bonds are to be issued The bank proposes to launch a bond issue for 5,000,000 florins, i e five times the paid-up capital, as soon as market conditions are propitious No declaration of policy has been made, but it is clear that the directors are now merely laying the foundation of the institute Most of their resources would go in the purchase of new issues, so that there should be more mortgage bonds on the market Also they are likely at a time like this to invest their resources in urban and communal bonds rather than in agricultural mortgage bonds, and only in countries where the political and economic outlook is fairly clear

Now whilst French capital was most interested in this group, German, Swiss, and Swedish capital played the leading part in founding the Internationale Bodenkreditbank at Basel It has a capital of 25 million Swiss francs, of which 5 million is to be paid in on the founding of the Bank It is to issue bonds to the public and purchase the bonds of mortgage banks Although it promises to be a larger body, it has no features which distinguish it from the Amsterdam Bank [2] It would

[1] Other large groupings of mortgage banks has recently been effected or suggested The Credit Foncier de France is becoming in effect the central mortgage bank for the French Republic for her colonies and mandated territories

[2] Messrs Lazard Frères, of Paris, is represented on the directorates of both these banks

seem, however, to lay special stress on the possibility of granting loans on mortgages as well as engaging in the purchase of bonds

Parallel with this Central Institute for Mortgage Loans is the projected International Institute for Agricultural Credits, to be created under the auspices of the League of Nations Its object would be to help to make available loans for agricultural purposes in the countries of Central and Eastern Europe on the basis of mortgage security The rates now paid for loans by farmers is, as a rule, between 10 and 20 per cent, and occasionally rise to even 50 per cent With improved organization and more capital available the rate, it is anticipated, can be lowered to, say, 7½ to 10 per cent, varying with the nature of the security offered, which will, in turn, depend on the mortgage law, on the existing banking organization of the countries and their credit status. Clearly, if the proposed International Institute could place its bonds with the public, say, at 6 per cent, it would profitably invest in the bonds of the local mortgage banks There is no intention and, indeed, no purpose in its lending directly to the individual agriculturalist By purchasing the bonds of mortgage banks it uses their machinery, experience, and knowledge for its purpose without costly duplication

With the authority of the League of Nations behind the proposed Institute, it is regarded as certain that both the capital for the bank and for the purchase of its bonds would be forthcoming from the general public The latter, it is anticipated, will be sold in the capital exporting countries It is evident that the Institute is to be run as a profit-making concern, although the support of the Governments is being granted for its foundation But they are not to be invited to invest in the capital nor in the bonds of the bank Until, however, it can build up a reserve as additional security for its bonds out of its profits, it is proposed to constitute a special reserve from advances made by the various Governments It remains to be seen whether they will be asked to standardize their mortgage law, and grant taxation privileges to its bondholders

The amount of capital to be issued, the administration and control of the bank have not yet been decided upon But assuming, as it has been suggested, that it should be founded with a paid-up capital of 5 million gold dollars, it will invest this in the bonds of the central mortgage banks of the borrowing countries or, where such a bank is lacking, in the local mortgage banks This will enable them to extend their agricultural loans On the basis of this capital bonds up to an amount equal to 50 million gold dollars could safely be issued and sold to the public

Although the project is still in an early stage,[1] no insuperable difficulties of a technical nature are anticipated

A serious criticism may be directed against the proposal that the International Institute should merely buy bonds of the existing mortgage banks It may be said that it will silently countenance every uneconomic policy of which the latter may be guilty This is a wrong way of visualizing its future On the contrary, the Institute will be on the alert to protect its bondholders against such eventualities As a large purchaser of bonds it will be able to make proper representations to the local banks It will be able to express its views whether too much lending is taking place during the early years of the foundation of an agricultural bank, or during boom periods, if that tendency should manifest itself Without possessing powers of control then, it will be able to influence the local institutes [2] The major problem for the moment, however, is not the danger of an unsound over-extension of credit to small and backward nations It is rather how to obtain for them urgently necessary capital It is to be anticipated that if under the influence of the International Institute the State improves the mortgage law and the banks improve their machinery and their technique, then other investors will be attracted into this field and will make direct investments

Not quite the same danger exists for those constructing office buildings and apartment houses, although here, too, a

[1] March, 1931
[2] See Chapter VII

mortgage bank which forecasts the future wisely may save society from great waste and certain investors from heavy losses

The peculiarity of real estate is that a slight lack of accommodation results in a rapid increase in value as shown in price or rent The speculative builder with limited experience may find that he has calculated his rents on a wrong basis if he expects these to continue Calculation of birth rate, the trends of population and of industries, movements to and from certain areas, towns and districts, changes in the type of building taxation—these are problems which ought to be considered in weighing whether more buildings shall be constructed The rough and ready methods of the present-day builder might lead later to the abandonment of whole areas In both agricultural and urban real estate development it is not enough for the banks to learn whether the applicant for the loan is hardworking, reliable, and sober, and to apply their other normal tests During a period of rapid change their inquiry must be directed in the first place to the industry as a whole

The International Mortgage Bank being outside the immediate pressure of local facts and the confusing influence of local patriotism can observe phenomena more calmly and judiciously It will not merely purchase the bonds of the local banks when it can buy them most cheaply and thus incidentally lessen their range of fluctuation But it will be in a position to counsel local banks who desire its help Certainly, the international agricultural bank and the international mortgage banks devoted to the urban loans will be able to save the national mortgage banks from the chief dangers which beset them But the main test as to the value of these international organizations will be whether they attract more capital into this field of investment There are many who avoid small undertakings, however sound English investment bankers, for example, prefer large and reputable Governments and well-established concerns as borrowers They were until recently inclined to frown upon the ordinary industrial at home, and

would therefore show little interest in the small foreign mortgage banks But central mortgage banks and, above all, international mortgage banks will be able to offer better security. This cannot but weigh heavily with all the capital lending countries At the same time, loans granted by an international bank, or investments made by it, are less likely to be made to subserve any political purpose or the special economic interests of any one country

The institution of these international banks in the year 1931 indicates that, in the opinion of the leading financiers of a number of countries, mortgage bonds are undervalued, and also that they do not think it wise to wait and allow the undervaluation slowly to correct itself through their gradual absorption by foreign capitalists, by those who realize that they are attractive investments Their purchase will tend to raise their price, lower the rate of interest on future issues of mortgage bonds, increase borrowing, and thus tend to improve the normal processes of trade, to stimulate exports and imports

It has been suggested that the most urgent need as a remedy for the immediate trade depression, and for the more deep-seated and lasting difficulties of the international trade situation, is for some redirection of savings into the more adventurous trade channels into which they used to flow before the war, to provide openings for British goods, employment, and enterprise Since the war, it is argued, the tendency has been for national savings to take refuge in mortgages, debentures, and the fruits of past enterprise Whereas nearly three-quarters of our savings are believed to have gone to stimulate new industrial enterprises before the war, less than half that amount is believed to be thus employed at the present time This contention would seem to have little weight It is arguable, of course, that it is more profitable to invest in industrial undertakings But if capital is invested abroad in fixed securities it can only be sent out in the form of British goods, and the borrowing country will have control over larger capital resources

The growth of the mortgage bank, the local, the national, and the international bank, enables certain classes of borrowers to obtain long term credits on the security of real estate in the capital market, and thus assimilates them to other classes of borrowers But many other changes would be necessary for the two to be completely assimilated

Real estate development, whether of agricultural or urban property, would have to be on a large scale. Apart from plantations and cattle ranches and some experiments in large-scale farming, the agricultural world, as a whole, still operates on small or moderate sized farms On the other hand, there is a growing tendency for urban real estate companies to become large-scale organizations Commerce and industry, by adopting the joint-stock principle, have divorced ownership from control and have introduced the manager whose abilities recommend him as the fittest person to administer the business In agriculture these developments have rarely occurred, whilst in urban real estate there are the definite beginnings of the same kind of growth Commercial companies may increase their working capital by issuing ordinary shares, preference shares, and debentures Agricultural real estate undertakings are now able to borrow through the issue of mortgage bonds by an intermediary But urban real estate companies can themselves go out on the market and adopt the same methods and devices as the commercial companies

The development of the mortgage bond and its perfection should not blind us to the fact that the method of raising capital by this means is rigid, as compared with that usual in other businesses operated by commercial companies The growth of frequent trading in urban real estate, the large scale on which it is possible to operate, the increasing facilities for the average investor to take risks, provided that he is satisfied in the management of a concern, are all forces making for the adoption of the same financial methods for real estate as are usual for industry and commerce Granted that a real estate management corporation has already shown its efficiency and has won a high reputation in that field, there seems no reason why

real estate securities should not be offered to the public on the usual company basis [1]

Ordinary and preferred shares can be used in place of the mortgage bond It is quite conceivable that investors will, in future, be as willing to take an interest in real estate as they do in other types of security without requiring any special guarantees or safeguards This explains the growth in the number of land and development companies The National City Company of New York, which is already interested in the United States Realty and Improvement Company, is expected, when investment conditions are again normal, to adopt this policy [2]

Should this prove successful the necessity for special institutes would partly disappear An elaborate code of regulations would not need to be imposed by an outside authority Those who administer such companies will, however, be largely guided by these regulations which embody the results of past experience in this business But more elastic conditions will be possible Such companies would not only lend on mortgage, but, perhaps, own and administer their own and other people's property, and share in large development schemes Specialized knowledge and machinery could be used more fully The chief advantage of the shareholder over the bondholder will be that he shares in the rising values of the property owned by the company and, as in the case of the Dutch mortgage banks, in the profits of the company But it is certain that for many years a very large number of investors will prefer to enjoy, for the whole or for part of their capital, the assured income of bonds at the same time that owners of property will wish to borrow on mortgage For the small property owner the mortgage institute offers many advantages There is no question of the new real estate company ousting completely the mortgage bond institute, at

[1] An interesting example of this tendency is the Beaux Arts Apartments, Inc , whose capital consists of First Preferred and of Common Stock

[2] *Financial News*, 7th January, 1930

least for decades It may be regarded as an integral part of the structure of the capital market

There has grown up within recent years a general recognition of the basic significance of mortgage banking in economic and social life Rural credits, building credits, long term credits for industry, these are regarded as among the most important and pressing needs in all countries Previous to the war, the prevailing thought of most business men and even of professional economists appeared to be that banking and credit had become adjusted to the needs and habits of different countries and classes Broadly speaking, it was assumed that all who deserved credit could get it This view is now challenged, if not changed There is widespread belief that certain activities are being badly served with long term credit even in such countries Moreover, the community as a whole is now profoundly interested and concerned in the functioning of the banks. They are no longer regarded as mysterious, suspicious entities of little real importance to the individual They are now widely recognized as important instruments of social control Their significance is recognized to be in the bearing they have upon production and in the direction of capital Mortgage banks in particular, it is seen, may stimulate production along certain channels Even deposit banking has come to be regarded nowadays as being as essential as any public service, and this applies with even greater force to mortgage banking

What has led to the world-wide growth of mortgage banks? Surely conditions have not changed fundamentally, and the need for their services was felt also previous to the war Why then the insistent demand for instituting mortgage banks to-day?

In large part it would seem to be one of the consequences of the amalgamation movement in commercial banking The great and rapidly increasing growth in these banks and in their power over the money market has made them face the long standing demand for long term credits The big organization has to meet public expectations which the smaller banks could ignore As their resources increased and their position

was strengthened, their scope was widened They must, in spite of their reluctance, either themselves deal with this demand for long term credit, or create the necessary instruments for doing so Perhaps the demand was accentuated in consequence of the keen competition for foreign markets, which resulted in a relative increase in the amount of credits which went into the exporting industries and a corresponding decline in home credit

The war left many countries so exhausted that savings disappeared and desirable undertakings languished for lack of capital. The central banks were fully occupied with Government needs—with exchange problems, with tasks relating to temporary balances, short term loans, and the refunding of debt [1] They had little desire to be diverted to problems relating to long term loans They were more concerned with assisting the Treasury than the business world They were, therefore, desirous that the proper means should be found of approaching the capital market for long term loans in order that they should be left to their accustomed tasks Similarly, the commercial banks wished to devote themselves to their own functions, the chief of which they regarded as the grant of short time accommodation to business men concerned with the handling of goods Even the German banks, with their long tradition of sharing in the risks of industry, were eager to shed the responsibility for providing long term banking facilities But the post-war conditions made this policy impossible for them

The banks have felt a great pressure to grant a larger amount of time deposits as compared with demand deposits They hold a greater proportion of long term investments and loans on securities than was usual The big joint-stock banks and the central banks have carried a large amount of frozen

[1] All the leading central banks confine themselves to acting as bankers to the Government and to other banks They avoid competing with the latter for ordinary banking business The Bank of France is the chief exception to this rule On 3rd July, 1930, it held £45 millions' worth of commercial bills discounted at its 257 branches and auxiliary offices all over the country

assets in recent years These conditions necessarily force them to devise better long term facilities in order that they should be freed from this type of activity They welcome the establishment of companies which relieve them from the necessity of tying up a considerable portion of their resources in non-liquid funds, which would result from making advances on real estate At the same time it should be noted these companies compete with the banker for deposits, but their activities are of a kind which the bank would not handle—the issue of debentures, and the collection, at considerable expense, of small contributions

Having examined the main general features of the mortgage bond as an investment security, its recent development and tendencies, we will now proceed to illustrate and modify it by concrete examples. The study of specific mortgage bonds in the chief countries should give us a closer grasp of the real situation than we have so far attained We shall attempt a comprehensive survey of the leading banks and bonds quoted on the international markets, and submit a tabular representation of the characteristics of the various issues Since many countries contain examples of a number of different types of mortgage bank, it will be more convenient to set out the material on a geographical basis—a procedure which will enable us, also, to discuss the different countries as markets for these bonds

One of the obstacles which confronts a realistic study of mortgage bonds lies in the fact that different series have to be compared This comparison may be very misleading Many bonds are issued in countries which have changed over to a gold standard But they did not go over to the gold basis at the same time Some bonds are issued at a premium, and some at a discount Some are to be redeemed at par, and some at a premium Sinking fund arrangements vary Different policies are adopted with respect to the support of prices on the market Most have a local market, some are sold on two and a few on more Exchanges The prices quoted vary,

in some cases it is the average, and in some the last price of the day Those which run for some time have been subjected to changes in the law It is therefore much safer, as a rule, to compare the mortgage bonds of any country with the Government bonds and industrial debentures of that same country, than with the mortgage bonds of other countries

It will be convenient to examine the leading countries which are representative of different types of mortgage bank system Germany will come first because of her experience and the catholicity and the variety of her banks, France next with her monopolistic centralized system of joint-stock mortgage banking, the United States will come third because of its colossal Government system and the interesting new features she has developed, such as mortgage bonds issued on a single building, and the guarantee of bonds by private companies, and a special real estate exchange for the sale of securities Sweden should perhaps come next as the country with a centralized bond system and a decentralized banking organization with Holland as the country where banking and bonds are subject to no special regulation But England will come next to illustrate what substitutes have sprung up in a country where no mortgage banks proper existed until recently, whilst Sweden and Holland are dealt with later more briefly Short notes will suffice to indicate the long term credit conditions in other countries.

PART II

MORTGAGE BOND SYSTEMS IN VARIOUS COUNTRIES

CHAPTER IX

GERMANY

GERMANY is recognized both as the founder and as the home of the mortgage bank, the mortgage bond, and a developed system of real estate credit Her long experience in this field, and the high development and strength of her mortgage organization, has had a considerable influence on other countries [1] At present her credit situation is a fairly typical sample of that prevailing in most Central and East European countries and is, therefore, all the more instructive We shall be justified then in dealing with German conditions at some length

The financing of mortgage loans by bonds is used for all kinds of real estate credit agricultural credit, urban real estate credit, communal credit, and, in recent times, industrial credit Whilst in the South of Germany some of the private joint-stock companies grant both agricultural and city real estate credits, they specialize in the North in the issue of bonds secured against urban mortgages, the agricultural business being concentrated there in the hands of public institutes which are either State banks or co-operative associations

The fact that "the public law banks" were originally established in a period of emergency, resulted in their not being run primarily for profit This name of public law (offentlich rechtlich) is applied not only to the State or municipal banks, but also to the co-operative associations, i e to non-profit

[1] Bagehot ascribed a large part of Britain's commercial supremacy over continental nations to the superior organization of her credit Germany's leadership on the Continent in the pre-war period was, in part, due to the skilful organization of her capital market, in which her mortgage banks played an important *rôle*

making institutes The private joint-stock companies, on the other hand, depend for their growth chiefly on the financing of urban credit with a view to gaining a competitive profit

Let us first inquire into these profit-making concerns, and then into the different types of public banks, the landschaften, i e the co-operative associations and the State banks The organization of the private joint-stock banks, which although operating with capital provided by shareholders, is under strict Government supervision, is controlled by the Mortgage Bank Law of 1899, amended by the Acts of 1923 and 1926 The growth of confidence in the security of mortgage banks may be said to have begun soon after the newly-enacted law revealed certain weaknesses, which led to the collapse of two institutions This gave occasion to the keying up of their regulation and supervision The scope of the activities of these joint-stock banks is sharply circumscribed, consisting for the greater part in the granting of long term loans on mortgages to ordinary businesses on the security of their property, and advances to German municipalities, and to the issue of mortgage and municipal bonds against these loans In addition to their main activities, the banks may fulfil certain functions which are regarded as a variant of, or subsidiary to, the mortgage business itself such as the acquisition and sale of existing mortgages, the grant of loans to domestic narrow-gauge railways, and the issue of bonds against these advances, certain sorts of commission business, as, for example, the purchase and sale of securities on foreign account, the receipt of deposits up to 50 per cent of the paid-in capital of the bank, and the temporary investment of free funds in first-rate securities Broadly, the object aimed at by the law is to prevent these banks from engaging in any unusually risky enterprises

The mortgage bonds issued must be covered to the extent of their nominal value by mortgages of equal value, and bearing in their total at least the same rate of interest If this cover should temporarily prove to be insufficient it may, for the time being, be replaced by Government securities Liabilities under the bond issue must, moreover, remain within a

certain proportion to the capital The bonds may not exceed 20 times, and where municipal bonds are issued, 28 times the amount of the capital plus reserves set apart as cover of the bonds From a representative list of twenty-two banks it was found that the bonds varied from 17 times the capital and reserves to 7·5 times—the average being about 12 times

Loans may not be granted except on first mortgages, and must keep within 60 per cent of the value of the property In accordance with the post-war revaluation the loans are, in fact, limited to 15 to 40 per cent on city property, and 25 to 30 per cent on rural property Half of the agricultural loans must have provisions for amortization

The oldest private joint-stock company engaged in this business is the Bayrische Hypotheken und Wechselbank, established in 1834 The mortgage operations of early banks were handled in departments separate from their credit banking activities, and this one still carries on a mixed banking business The private mortgage banks which began to develop in the early sixties were, however, pure mortgage banks, and no new mixed banks were allowed to be established in Germany

The law of 1899 required that licences be obtained before beginning business No special privileges have been accorded to these banks, the regulations being merely restrictive The fiduciary agent, or trustee, checks the data of the valuation on which the loans are granted, and inquires into the sufficiency of the cover for the mortgage bonds which it is desired to issue, and this is entered into a special Cover Register He has joint custody with the officers of the bank, to which he is assigned, of all papers connected with the bonds He has absolute custody of the mortgages used as security, which he holds as a trustee, and must attach his signature to all loans In the event of bankruptcy the mortgage bondholders have a preferential right to the securities entered in the Cover Register

The municipal bonds are covered by loans to such public corporations within the country as do not wish to appeal directly to the public for long term loans These are like the

other loans entered into the Cover Register and controlled by the trustee The municipal bonds are authorized investments under the law of trustees

The laws governing Landschaften, Stadtschaften, and other public institutions vary with the locality, but, in general, the provisions of the law of 1899 apply also to these institutions. The oldest public banks are those of the Landschaften, the co-operative associations of landowners, the first of which was established in 1779 The old Landschaften were empowered to issue debentures on the properties mortgaged by the borrowers and the assets of the association, on the joint and several liability of the members who received the bonds in exchange for their mortgages Each Landschaft was created by a special provincial act which gave it the right to operate within its prescribed area The older associations were compulsory All landowners were obliged to assume liability, and all had a right to credit The new Landschaften are voluntary organizations. Permission to become a member and obtain credit is optional They, too, are co-operative associations, and are not operated for profit They are not all exactly alike in the matter of liability and management Still they have essentially the same method of carrying on their business Previous to the war, the association appraised all the land already improved or capable of yielding an immediate revenue within its sphere of activity, took mortgages from members who desired credits, and gave them debentures in exchange The credit limit was fixed, as a rule, at 50 per cent of the appraised value of the estate The borrower sold his debentures in the market for what they would bring There was, in fact, a steady demand for them at a good price

The borrower pays an annuity in half-yearly instalments These remain the same as long as he is in debt The portion of the annuity which represents payments on the principal is invested to the account of the borrower, and gradually the property is relieved from debt

The Landschaften have no, or only a small, capital The only additional security for the bonds issued, besides the

mortgaged property, is provided by the mutual liability of the members This liability is met in different ways sometimes it is covered by all the real estate which members possess, sometimes it is extended only to their mortgaged property, sometimes it is limited to a percentage on the loan Some of the new Landschaften have instituted a guarantee fund made up of extra contributions in place of the older, more burdensome mutual liability The borrowing members of most of the associations are now liable only to the extent of their mortgages

The sale of his debentures by every borrower in time proved clumsy Most of the co-operative associations, therefore, organized special banking departments primarily with the purpose of selling and buying their bonds on the market The need for a central organization for standardizing their business methods and strengthening their credits by mutual assistance became apparent between 1872 and 1875, during the agricultural crisis, when the market price of the bonds of several associations was low and unstable Inasmuch as the guarantee these bodies offered was as good as the guarantee of the well-known Landschaften, whose bonds were sold at a satisfactory price, it was evident that the difference was due to distance from a big monetary centre and to adverse local conditions The effort to establish a central organization with power to issue bonds upon the combined guarantee of the Landschaften, with all Europe for their market, has been only partially successful

The Central Landschaft of Prussia, organized in 1873, was made up only of eight Landschaften The others did not join because their bonds found a ready market within their own provinces The Central Landschaft has neither capital nor other funds additional to the sinking fund accumulated from the contributions for the retirement of the bonds, and the special reserve fund obtained by the few gains from sales of bonds at a premium Its members are the other co-operative associations They deliver their bonds with the other necessary documents in exchange for the collateral bonds of the central body It acts as a central agency for distributing bonds

and the larger issue tends to lessen fluctuations in bond prices As with the older Landschaften, the rights of foreclosure, the issue of bonds, the methods of amortization are not unlike those of the joint-stock mortgage bank

Side by side with the co-operative land credit associations there grew up another group organized by States, provinces, and municipalities which grant real estate loans

The State, provincial, or district banks differ considerably from one another in function and organization, but work, more or less, on the same lines as far as their mortgage credit business is concerned They are all non-profit-making and serve, especially, the owners of small- or medium-sized property They grant long term mortgage and communal loans, and issue bonds to raise the money needed They are secured by State guarantee Loans are made in cash All the profits of the bank are used for reducing the rate asked for loans, or are devoted to public purposes The banks are exempt from stamp duties and registration fees, they enjoy the free services of State officials, and possess other special privileges in enforcing the collection of their claims

Having examined the organization of the joint-stock mortgage banks and of the Landschaften and State banks, and seen how they function, we may proceed to trace the effect of post-war conditions on their development

The economic dislocation arising from war conditions, and the post-war reorganization of the currency, have impaired the German mortgage credit system, and the recovery is slow In the first few years after the war a large proportion of the loans outstanding were repaid owing to the low value of money, and the corresponding bonds were retired The business then tended to decline During the second half of 1923 the German Mark dwindled in value, and after a brief experiment with rye mortgages and mortgage bonds as a basis of the currency, a new one based on the gold standard was introduced The mortgage institutes were at this time in a grave situation since their capital and their considerable reserves were still calculated in paper marks

The Revalorization Act of 1925 laid down on a complicated basis that the major part of the pre-war mortgages securing the mortgage bonds was to be re-valued at 25 per cent of the pre-war figure The mortgage creditors received payment for the greater part of their claims in the form of special mortgage bonds, "Liquidationspfandbriefe" carrying interest at 4½ per cent drawn in gold marks, and as further claims are established they obtain a further distribution of bonds The claimants have a marketable security that is dealt with on the bourse The total used and now in circulation is estimated at 1,500,000,000 reichsmark About 85 to 90 per cent of the liquidation mortgage bonds will probably be repaid between 1932 and 1935 The remainder have amortization funds with which they are to be redeemed later

One of the results of this revaluation was that the bonds of private mortgage banks were valued more highly than those of public bodies. This raised the credit of the former relatively to the latter, and explains why the bonds of private mortgage banks often stand now higher than those of public companies, although previously to the war reverse conditions prevailed [1] When stability in values was again established the business developed enormously, but owing to the insufficient capital the banks experienced difficulties in raising the money necessary for loans The mortgage institutions were in a worse state than the credit banks, since the latter could satisfy their long term capital requirements by means of short term money

During the inflation period Germany, in common with other Central and East European countries, slowly restored and built up her fixed capital But with the reorganization of the currency these countries were bare of liquid capital In view of this shortage it is not surprising that they became heavy borrowers in the U S A and in Great Britain The size of these

[1] Report of the Association of German Mortgage Banks, 1926 "Prices of mortgage bonds are continually and to some extent considerably higher than those of the qualified bonds of the State and municipalities, as well as those of the qualified municipally secured bonds of the mortgage banks and those of the greater part of the qualified bonds of public credit institutions bearing the same rate of interest"

foreign borrowings caused considerable uneasiness in Germany, and it may be assumed that the amount would have been still larger had not a certain restriction been enforced. The impoverished countries became very dependent upon the international market, i.e. upon elements outside their own economic control, and this reacted on the organization of the mortgage banks. In order to increase the issue of their bonds they adopted various devices to reduce competition among themselves. The desire to avoid a scramble by a host of institutions led to the rationing of available sources, and this necessitated an understanding not merely as to the nominal rate of interest, but also as to other matters without which the rate would be ineffective. The private joint-stock companies came to far-reaching agreements as to the conditions on which to issue bonds.

During the period following the war four groups of mortgage banks established a more or less close community of interests. The most important of these groups, the Gemeinschaftsgruppe Deutscher Hypotheken Banken, comprising six leading banks, provided for a rigid centralization of their capital for the purpose of attaining common aims. All profits and losses were pooled between the banks with the effect that the liabilities of any one were in reality secured by the combined capital strength of the six. Whilst the two smaller groups, comprising together seven banks, are working exactly on these same lines, the Suddeutsche Gruppe, consisting of six important institutions, does not go so far as to pool the profits and losses of its members.

All the joint-stock companies, whether belonging to one of the associations or not, follow the same policy as to the rate of interest to be paid on new issues. The practice of giving the purchaser of bonds a certain commission lowers their price, and they endeavour to adjust the nominal price to the actual market price. It should be clearly realized, however, that no attempt to place these bonds in a strait-jacket is likely to succeed. Some flexibility of price must be allowed for. The so-called abuse of reselling mortgage bonds, and

especially of municipally-secured bonds below the Stock Exchange quotation, arises from the fact that that quotation may be rigged and is sometimes too high, and that there is no ready market for the bonds at that price

No attempt has yet been made by the private mortgage banks to provide for a centralized bond issue, a device adopted by some of the public mortgage institutions, but amalgamation of mortgage banks is beginning to play a very important part in the process of rationalization In 1930 most of these banks stated that their loans would be repaid in gold, a step which would tend to eliminate the dangers of inflation to the lender They borrowed at about 8 per cent, they are getting an additional 0 70 to 1 56 per cent on their mortgages Most banks carried a clause to the effect that there should be no redemption by purchase before a certain date

All the Landschaften were already in existence previously to 1914 In the period of the war and of inflation the history of these institutes was similar to that of the joint-stock companies But the public banks were, indeed, even worse hit than the private joint-stock companies, because of the necessity which they were under of working within more rigid limits They could no longer afford to grant loans free of administrative charges, or have a narrow margin between the price they paid for their bonds and the amount they charged Owing to the post-war economic developments, therefore, there has been an increasing tendency for the public banks to conform to the methods of business employed by joint-stock companies To raise money on foreign markets they had to accumulate a capital of their own The foreign investor, used to measuring the credit standing of companies by usually accepted standards, judged the bank largely by the amount of its capital and its reserves Other changes, too, were necessary Whilst until 1927 most of the associations delivered bonds to the borrower, and only a minority made the loans in cash, the former method has now been almost entirely abandoned because the unorganized selling of bonds on the market in times of adverse money conditions influences the prices very

unfavourably The issues of the public banks are now subject to the law of the 21st December, 1927, which has necessitated bringing about considerable changes in their business methods The law regulates the issue of bonds in a way similar on the whole to that of the private mortgage banks, but, nevertheless, allows some important differences As the public banks are regarded as part of the civil service there is no need for a trustee And there is also no legal limit to the amount of loans granted, though, in practice, the public banks follow the policy of the private joint-stock companies For the time being mortgages on agricultural land are granted up to 30 to 40 per cent of its appraised value Mortgages on city real estate are granted up to 25 per cent, and in the case of apartment houses erected after 1918 up to 40 per cent of the value

The public banks usually worked within a limited area which was also the market for their bonds The traditional buyers of these bonds no longer able to invest on a large scale, the banks now depend much more upon investments of the financial centre, Berlin, which has grown so important since the war Following the example of the joint-stock banks, the public banks have created central organizations representing their interests and ensuring a common policy of bond issue They, too, found a difficulty in the sale of bonds It soon became clear that the existing organizations were unable to obtain the capital required either at home or abroad A change had to be attempted New institutes had to be erected In 1923 a Central Institute for the State and Provincial banks with power to issue its own bonds was established

The central bank for the whole agricultural mortgage system, the Rentenbank Kreditanstalt, was established in 1925 This bank grants credits to public institutions and to institutions under State supervision, which furnish either mortgage credits or personal credits for agricultural purposes It must not approach the German capital market Mortgage bonds which may amount to six times the amount of the capital of 500,000,000 reichmarks, are placed either with State institutions or sold abroad Out of the net profits a reserve fund

equal to one-tenth of the capital which was provided by the State, and a special reserve for the bonds issued equal to 5 per cent of the bonds outstanding, have to be accumulated Long term credits are granted to agricultural organizations against first mortgage or mortgage bonds which are additionally secured by the liability of the borrowers for the unamortized principal of their loans

It is frequently argued that the Rentenbank has been particularly successful with its foreign issues because of its capital, its name, and relation to the Reichsbank, and because it did not accept the principle of undifferentiated security, but provided a special cover easily controllable for each series of bonds It is, however, clear that the better conditions obtained are largely due to the size of the bank [1]

Public banks are still leading in the agricultural credit business, and they have extended their activities to urban credit and to the financing of industry

Compulsory legislation after the war, which has only recently been abandoned, respecting the rents of apartment houses and dwellings, depriving the owner of the full control of his property, greatly influenced the credit granted on urban real estate. Prior to the war, 60 per cent of the new buildings were financed by first mortgages, in 1928 this amount was reduced to 30 per cent Since the stabilization until the end of 1930, about 14,000,000,000 marks have been invested in new house property Of this 8,000,000,000 marks has been raised out of public funds The larger part of it has been raised in the form of a rent tax on houses (Hauszinssteuer) This special tax was meant to offset the gain to houseowners whose property had been mortgaged, and who were called on to repay only 25 per cent of the value of the mortgage The proceeds of this tax are chiefly used to finance building by granting second mortgages to an amount equal to about 40 to 50 per cent Thus, the builder of new house property obtains a first mortgage of

[1] It is noteworthy that the dollar bonds of the Rentenbank suffered most during the September, 1930, decline in securities consequent on the election of the new Reichstag

about 40 per cent, a second mortgage of 40 to 50 per cent, and he must find the remainder of the capital himself

On the model of the Landschaften co-operative associations for urban real estate credit, Stadtschaften were established, working, as a rule, with the additional guarantee of the town or the county Nearly all of them are located in Prussia They, too, have formed a central organization on which they have conferred the exclusive monopoly of bond issue On the model of these organizations State mortgage banks have been established for the financing of dwellings

Finally, co-operative organizations specially designed for supplying credits to small- and medium-sized businesses have been created since 1924 A certain limited part of the demand for long term industrial credit is also covered by the joint-stock mortgage companies and some by the State banks This type of credit is limited to industrial undertakings in big towns whose real estate and buildings have a value independent of the production carried on in them at the time

These industrial mortgage banks differ in the details of their organization from one another, and are characterized by far-reaching provisions for additional security, both as to the methods of granting loans and as to the guarantee behind the bonds in order to compensate for the accumulation of dangerous risks The most important of these is the State mortgage bank of Saxony [1]

The arrangements for guaranteeing security are regarded so favourably that mortgage bonds in Germany, whether issued in one part of the country or in another, by one company or another, give a fairly uniform yield Variations do exist, but these are chiefly due to the different rates of interest offered at the time of issue and different redemption periods

Another important consideration is whether they are recognized as trustee securities or not In pre-war time this factor made a difference in yield of about ½ per cent But a number have no sinking fund and no final redemption date, and these elements tend to reduce their price Savings banks and certain

[1] Cf table, p. 238

insurance funds are required by law to invest a considerable proportion of their deposits in certain specified bonds which are trustee securities, generally in those of the Reich, the States, the municipalities, or in other public credit institutions Not many mortgage bonds issued by private joint-stock companies are conceded the status of a trustee security The case for recognizing these mortgage bonds also as proper investment for trustees and savings funds is based on the new post-war situation It is pointed out that the rates at which the pre-war bonds of these companies were revalorized were higher than those of the paper-mark loans of the public bodies Prices of mortgage bonds of joint-stock companies are to-day higher than those of the States and of the municipalities giving a similar yield This is due to the general confidence in them Besides the mortgage banks are often of such utility for public reasons, say, for house building, that certain public funds are encouraged to invest in their bonds Surely, it is argued, if they are publicly favoured for investment, it follows logically that they ought to be given this extra privilege The recognition of mortgage bonds as a trustee security has been a question of policy on which different States have hitherto adopted different attitudes

Another modification of the existing law advocated by the mortgage institutions is the abolition of the tax of 10 per cent to which all issues made on the home market are subject This would be of special importance with respect to the foreign investor, it would create the urgently needed direct opening of the German capital market to foreign countries The sporadic placement abroad of entire issues exempt from taxation but precluded from listing on German Stock Exchange markets does not afford complete compensation Foreign investors justly claim that they should be placed in the position at all times to find in Germany a market for their German mortgage bonds

The comparatively small amount of the German mortgage bond issued abroad, partly due to conditions affecting all mortgage bond issues, has to be explained to a certain extent

GROWTH OF MORTGAGE DEBT AND MORTGAGE BONDS, 1927–30

1927			
Total value of real estate	RM	26,489,618,000	
Value of agricultural real estate (including forests and gardens)	RM	25,999,462,000	
Mortgages on city real estate	RM	2,637,000,000	
Mortgages on agricultural real estate	RM	2,037,600,000[1]	
Revalorization mortgages	RM	1,094,300,000	
TOTAL	RM	5,768,900,000	
(August), 1928[1]			
Agricultural mortgage debt	RM	3,383,500,000	(57.7%)
Total agricultural indebtedness	RM	5,855,900,000	
Individual and floating debts	RM	1,800,000,000	
Rentenbank real estate debt	RM	2,000,000,000	
30th June, 1929			
Total of mortgage bonds outstanding	RM	6,274,200,000	
Issued on foreign markets	RM	1,059,400,000	about 1/6
Total Communal bonds outstanding	RM	1,764,100,000	
Issued on foreign markets	RM	238,400,000	about 1/7
Total of bonds outstanding of joint stock companies	RM	3,407,100,000	
Issued on foreign markets	RM	162,900,000	1/20
Total of bonds outstanding of State banks and Co-operative banks	RM	2,054,600,000	
Issued on foreign markets	RM	360,100,000	1/6
Bonds outstanding of Rentenbank	RM	814,500,000	
Issued on foreign markets	RM	536,400,000	2/3

ISSUED IN GERMANY

	Mortgage Bonds	Communal Bonds
1926	RM 1,628,000,000	RM 465,000,000
1927	RM 1,597,000,000	RM 349,000,000
1928	RM 1,477,000,000	RM 491,000,000
1929	RM 835,000,000	RM 258,000,000
1930	RM 1,784,110,000	RM 549,000,000

OUTSTANDING ON 31ST DECEMBER, 1930

Total of mortgage bonds issued in Germany	RM	6,509,000,000
Total of mortgage bonds issued abroad	RM	1,013,000,000
Total of communal bonds issued in Germany	RM	1,907,400,000
Total of communal bonds issued abroad	RM	216,700,000
Mortgage bonds issued by private joint-stock companies	RM	4,396,000,000
Mortgage bonds issued by public banks	RM	2,277,600,000
Communal bonds issued by private joint-stock companies	RM	756,000,000
Communal bonds issued by public banks	RM	1,310,600,000

[1] 1913, RM 16,000,000,000

by the taxation and by the generally restrictive policy of the German Government

Bonds issued by mortgage institutes have become increasingly popular during the years 1929 and 1930 with home investors While these bonds represented only 30 per cent of the total of bonds issued on the home market in 1913, i e of Government bonds, mortgage and communal bonds, and of industrial bonds, in 1929 they represented 68 per cent

The post-war years have witnessed in Germany, as in France, a considerable increase in communal loans, of the total of bonds issued by mortgage institutions in 1913, 10 per cent, in 1929, 30 per cent were communal loans

In spite of all efforts to increase it and the high rate offered, the capital invested to-day in mortgage bonds in Germany is considerably less than what it was in pre-war days Home investors are turning to them increasingly, but have not the necessary capital to direct into this channel For the outside investor, on the other hand, there are now added to the usual disadvantages attaching to any mortgage undertaking abroad the very heavy external obligations of Germany But in spite of these it is safe to say that the disturbed capital markets of 1929 and 1930 were responsible for some of the neglect of German mortgage bonds

While the market for German bonds at home is so active, the business in foreign mortgage bonds which was extensive in pre-war days is now very limited The foreign bonds on the market are mostly 3 to 4½ per cent pre-war issues of Scandinavian, and Middle and East European countries, and dealings in them are almost stagnant Only very few issues, as, for instance, the Norwegian loans, are quoted regularly

CHAPTER X

FRANCE

FRANCE is the classical example of a country with a monopolistic mortgage bond credit organization.

In the beginning of the last century real estate credit facilities were in a bad condition, chiefly because of the lack of adequate laws regarding the registration of instruments affecting the title of possession to land. The law of 1852, specifying the functions of land credit institutions, laid down rules for making loans and for issuing debentures, prescribed the measures to be taken for adjudicating titles, and outlined the special privileges and restrictions under which the mortgage bond business must be conducted. The law did not indicate any preference for any particular form of mortgage credit organization, but State banks never came into existence in France.

At first it was intended to organize a mortgage bank for each department, and the Banque de Paris, established in February, 1852, was only allowed to deal within its own district. But in December of the same year the bank was granted the privilege of issuing mortgage bonds for the whole country, and its name was changed into Crédit Foncier de France. It was given a subsidy of 1,000,000 francs when it was started.[1] No further institutes were granted permission to issue bonds,[2] and the right of the then existing mortgage bond banks was acquired by the Crédit Foncier. The legal privilege granted to it expired in 1877. Its charter was extended for ninety-nine years from 1881. It enjoys, in fact, a virtual monopoly.

The Crédit Foncier, now operating in France, Algeria, Tunis, and Morocco, is a national mortgage bank which makes

[1] The foundation of the Credit Foncier was due to the economist M. Dolowski.

[2] A rival establishment was absorbed by the Parisian banks, which undertook contractually not to start any organization capable of competing with the Credit Foncier.

advances to agriculturists and townsmen on the security of first mortgages on houses and land Since 1929 it has been authorized to extend its activities to the French protectorates and mandated territories It has thus become an Imperial Mortgage Bank It is a joint-stock company, working under the control of the Government by reason of the privileges which the State has granted to it The Government control consists not only in the special law regulating the organization and the business of the Crédit Foncier, but also in the supervision of its administration It appoints the governor and two deputy-governors, the deputy-governors appoint all the other officials The governor is the representative of the State on the board of directors, and has control over all affairs not otherwise disposed of Even the decisions of the stockholders' meeting may be vetoed by him The only independent right of the 200 largest stockholders who meet once a year is to elect the council of administration Clearly, its organization was inspired by that of the Bank of France

The scope of business is that of a pure mortgage bank The two principal kinds of operations are mortgage loans and communal loans granted to departments, municipalities, public utility corporations, etc The latter may, or may not, be secured by mortgages The sources of funds for its operations are threefold first, the capital stock and reserves, second, money realized from the sale of bonds, and third, the deposits part of which are employed in carrying on ordinary banking business, such as short term loans as specified by law [1] The total of deposits according to its statutes may not exceed 100,000,000 francs The capital stock, amounting in 1930 to 300,000,000 francs, is now designed mainly as a guarantee for the bonds, the form of its investment must therefore be such as to render it liquid and always available for this primary purpose One-half is invested in Government and other securities used as collateral by the Banque de France, the other half for loan purposes

[1] Ordinary banking business is carried on with the usual restrictions common to pure mortgage banks in Germany and in the United States

The bond issue is fixed at fifty times the nominal capital, and must be covered by first mortgages The bonds are sold in large blocks by public subscription Previous to the war the amount of a single issue varied from 250,000,000 francs to 900,000,000 francs, the total issues in 1929 amounted to 3,000,000,000 francs mortgage bonds, and 5,000,000,000 francs communal bonds [1] The mortgage bonds have officially no fixed date of maturity, but the time limit for reimbursing the capital is mentioned in the prospectus of each issue The bonds are redeemed by annual or semi-annual amortization at par or at a specified price The Crédit Foncier enjoys the special privilege of issuing bonds which, in addition to the fixed interest, give a right to drawings for prizes Each issue of bonds with a lottery requires a special authorization by the Government, although it is exempt from certain preliminary legal requirements In contrast to German or American mortgage banks the Crédit Foncier may issue its bonds at a premium

Bonds may be issued before mortgage loans have actually been granted, whilst in Germany bonds may be issued only after the mortgages are contracted as the basis for the issue and have been deposited with the trustee The German banks, therefore, need a larger amount of their own capital in order to acquire mortgages as the basis for their issues

The Crédit Foncier has no mortgage bond register, is not supervised directly by the State in its dealings, and knows nothing of the institution of a trustee The control as to the quality of mortgages and the amount of bonds issued is limited to the measure that every bond has to be signed by the Governor and one of the directors The rule always insisted upon is that the face value of circulating bonds must not exceed the amount of outstanding loans Loans are granted on first mortgage up to 50 per cent of the conservatively appraised actual market value of houses and farms, and

[1] Mortgage indebtedness to Government indebtedness in France was considerably smaller than in Germany In 1913 the former had a mortgage indebtedness of 14,000,000,000 frs against 30,000,000,000 frs in Government securities In Germany there were 50,000,000,000 marks as against 30,000,000,000 of total bonded indebtedness

one-third of that of vineyards, woods, and other plantations These properties must have a steady and certain revenue Inspectors of the Crédit Foncier are in charge of the valuation, and the board of directors finally decides on the amount to be loaned The contract is filed with the public recorder, and steps are taken to make sure that there are no claims against the property mortgaged An important legal privilege, known as the purge, is granted the Crédit Foncier in this connection When the bank has taken all steps to assure itself that there are no registered claims on the property on which a mortgage is desired, it issues a brief official notice calling on third persons to make known any rights which they may possess against it If after three weeks no hidden claims are disclosed the bank may lend on the property, and its legal title becomes incontestable against any claims which may subsequently be brought forward The great practical importance of this device in creating and perfecting security is realized when the heavy legal charges in investigating title to property in England are considered

The maximum length of time for mortgages on real estate, either of landowners or municipalities, is 75 years, and on property liable to depreciate rapidly 30 years Short period loans for less than ten years are also granted

From 1856 to 1877 (except for an interval between 1869–1870) loans were made in bonds, since then the borrower has received cash

Long term loans without exception have amortization provisions The amount for amortization depends on the length of the loan and the rate of interest, the total interest and sinking fund is raised out of a fixed annuity, paid semi-annually If the loan is for a short term the borrower contracts to pay the principal or instalments and the interest thereon at stipulated times

The Crédit Foncier is empowered also to make advances to the Sous-Comptoir dés Entrepreneurs, a contractors' bank which lends on mortgage to builders when their work has reached a certain stage and while it is in progress When the

building is completed, the bills discounted by the Sous-Comptoir and rediscounted by the Crédit Foncier are cancelled by an ordinary mortgage to the latter

In 1928, under a special law regarding State assistance to shipping, the Crédit Foncier was allowed to grant ships mortgage credits

Communal loans are granted mostly for a period of 30 years The commune usually gives no security but that based on its ability to meet its budgetary obligations The communal bonds are issued against the credit granted by the bank In February, 1931, 1,500 million francs of communal bonds was issued at 4 per cent

An analysis of the loans granted shows a steady growth of the part used for the financing of city real estate credit The mortgages having been intended originally to aid agriculture, one-half of them were given in the country and one-half in Paris The constant tendency for urban mortgages to increase has resulted in the grant of twenty-two loans in the city to one loan in the country The activities of the Crédit Foncier have been greatly influenced by the war and the inflation Prior to the war mortgage credits on rural and urban property were most important, now they are secondary to communal loans The explanation of this development can be found in the increased monetary needs of the public bodies, the temporary decrease of building activities, and the repayment of mortgage credits during the inflation It is due in part to the fact that in the city trouble and expenses of operations are lower, and in part to the high standing of this bank which enables it to borrow and to lend cheaply

The Crédit Foncier is represented in the provinces by the General Treasury whose representatives are the financial agents for the receipt of payments and for all Treasury operations, and by the directors of branches who solicit mortgages and communal loans and help to realize on them

Although the Crédit Foncier has a monopoly of bond issue,[1]

[1] The other mortgage banks established in France, like the Credit Foncier and Agricole d'Algérie, the Crédit Foncier Egyptien, the

it is by no means the only source of mortgage credit in France As in other countries insurance companies take an important part in the financing of real estate credit, whilst agricultural credit is provided by co-operative associations working with Government funds For rural credits and for urban credits, the individual (notair) solicitor still plays an important *rôle*

The fact that the Crédit Foncier has not extended its activities more may be due partly to the lack of proximity to the customer, especially to the farmer The decentralization of the machinery for granting loans, which the Swedish system and the Federal Farm Loan system of the United States have so effectively combined with a centralized bond issue, is in marked contrast with the French system

It is important to note that the French institute, a large private joint-stock company run on capitalistic lines, has certain features generally connected with public banks Certain dividends are allowed to shareholders per annum out of the earnings After these have been paid, a definite amount has to be set aside for the obligatory reserve till it reaches 50 per cent of the capital stock Secondly, the rate of interest charged to the borrower must not exceed by more than 3 francs per cent the rate of the return (interest, lottery fees, and other charges) from the bond in circulation at the time when the rate of interest on the loans is fixed [1]

Crédit Foncier Franco-Canadien, etc, work exclusively in certain foreign countries or in French Colonies, and use the capital market of France only for the placing of their bonds The following table indicates their number of branches and their capital—

	Branches	Capital
Credit Foncier & Agricole d'Algérie	21	Frs 15,000,000
Credit Foncier Colonial	13	Frs 24,000,000
Credit Foncier Egyptien	1	Frs 80,000,000
Crédit Foncier Franco Canadien	3	Frs 4,748,000

[1] The legal regulation of mortgages and mortgage bond issue is less strict in France than in Germany Unlike German balance sheets, those of the Credit Foncier include, under liabilities, the actual amount realized from the sale on the market and not the nominal value of the bonds issued Both the mortgages used as a cover and the share capital are calculated in relation to this amount and not to the nominal value to be repaid But, on the other hand, whilst the German banks may grant loans up to 60%, the Credit Foncier is limited to 50%

France has never needed to go to foreign capital markets to borrow on the security of her mortgages, because she has always been able not merely to finance her own undertakings but to export capital Thus in 1911, whilst the total issues made in France of French securities was 17 4 per cent, that of foreign issues was 82 6 per cent of the total The accumulations of innumerable thrifty farmers and peasants are directed by the big banks with their numerous branches who act as agents for the investment market They are in a dominating position in France Without their support no large venture is possible It is partly due to their policy that the favourites with the millions of customers were not industrials or commercially-owned railways All forms of bonds—French rentes, foreign Government bonds, and Crédit Foncier bonds—were encouraged But it is contended that they are themselves in this respect the instrument of the Government which assiduously cultivates the habit in the citizen to place his savings in State obligations Previous to the war the bonds generally remained in the hands of persons of comparatively small means And even to-day this class is still of significance here, although it has been wiped out elsewhere The big financial institutions are also interested in this security, although the yields are not as large as they can obtain abroad Despite this tendency, and despite the fact that France together with U S A is the largest capital exporting country, the amount of post-war issues of foreign mortgage bonds in France is comparatively small The high tax on the issue of foreign securities and the reluctance to grant long term loans to foreign countries act as deterrents

Less than in any other country do French industrialists need the help of mortgage banks for long term credits The French rentier has received too many shocks to his politically stimulated taste for foreign loans, and such of his savings as the State loans do not absorb are likely to go to French industrial enterprises Certainly they are in a position to borrow at comparatively low rates compared with other countries

Our conclusion is that the main criticism of the simple well-organized French mortgage system is that, like French administration and the Banque de France, it is too much centralized in Paris This renders it open to political influences from which the whole French banking system suffers It is also subject to the criticisms of the provinces who are constantly demanding a more decentralized system

CHAPTER XI

THE UNITED STATES OF AMERICA

THE United States of America has become in recent years the biggest and most active market in the world for mortgages and mortgage bond investments based on real estate both within and outside of the country. With the growth in the acreage under cultivation, the increase in the value of land, and the larger capital necessary to equip and operate farms, agriculture fell into a condition in which special credit facilities for long period loans were needed. In a similar manner, the colossal growth of towns and the new type of costly buildings occasioned a demand for long period mortgage credits. Owners of landed estate borrowed capital at higher rates than borrowers in many non-agricultural industries, and a demand for greater facilities became urgent. The devices which sprung up spontaneously elsewhere became common also here, and, later, despite the introduction of the more organized machinery for providing such loans encouraged by Government measures, the older methods still continued. Mortgage legislation in the U.S.A. has for the most part followed the lines of the English law which is based on the common law modified by equity. But the extent to which the principles of equity have been substituted for the rules of the common law varies in the different States.

Many mortgages are effected either directly without the intermediary of any third person or with the aid of local solicitors. Local farm brokers provide credit. Many mortgage companies, commercial banks, and trust companies have farm mortgage departments; this applies not only to the commercial banks of smaller towns but also to some of the larger institutions. Many of the small State commercial banks and the trust funds invest in farm mortgage securities. Savings banks and insurance companies are important purchasers of mortgages. The Federal Farm Loan system is an important source of new loans

The business of farm mortgage banking in the United States has developed principally within recent decades The volume of borrowing by agricultural interests for capital purposes, however, is, as we have seen, not fully measured by the amount of mortgage and bonded indebtedness

It is difficult to give a definition of the private mortgage bank in the U S A which includes all the institutions doing this type of business It has been, however, attempted for practical purposes Article II/1 of the Farm Mortgage Bankers' Association states "Any National or State bank, Trust company, corporation, partnership or individual, in good standing, having a paid-up capital stock and surplus of $25,000, and which makes a practice of loaning money on the security of improved farm land, and publicly offers such securities for sale shall be eligible to membership in this Association" Each member has the power to deal in loans on real estate and to issue bonds, as a rule, the corporations may lend on any kind of improved real estate, the organization and administration of these companies being similar to that of the ordinary corporation The typical farm mortgage company solicits mortgages throughout an entire State, or in some cases in a few neighbouring States through a system of local agents The amount loaned on a first mortgage varies from 33⅓ to 75 per cent of the appraised value of the farm, mortgages are given for a period of 5 to 20 years The average rate of interest in recent years has been 6 to 7 per cent The commission deducted from the proceeds derived from the sale of the mortgage is payable as a lump sum, or in instalments secured by the borrower's notes and a 2 per cent mortgage on the property Previous to the institution of the Federal Farm Loan system, the commission to the bank was usually represented by a margin of 2 to 6 per cent on the principal of the loan, payable annually This business became so well organized that many British insurance companies bought mortgages systematically on property in the U S A

Many of the farm mortgage companies have in recent years started the issue of bonds Their issue is subject only to

occasional and systematic governmental regulations They are secured by the mortgages purchased They assign the mortgages to a trust company which holds them for the protection of the bondholder, who has also a claim against all the assets of the company, usually invested in mortgages If the bonds run for a long period of time, amortization arrangements are usually adopted The banks employ much the same methods of placing their issues before the public as bond houses, they advertise in the daily Press, circularize lists, etc The several hundred farm mortgage banks are independent business enterprises, most of them restricted to their local markets where they enjoy a good reputation Unfortunately, the costs of advertising a $10,000 mortgage is nearly as much as of a $500,000 bond issue If they would syndicate their issues, provide an appraisal system, national in character, and put a standardized security on the market (which would not necessarily involve the establishment of a central issuing institute after the Swedish example), they would be able to reduce their costs and to compete more efficiently with the Federal Farm Loan system banks over which they possess the advantage of not being tied to a fixed relation between the bonds issued and their capital stock Some of the private banks have, however, successfully syndicated their issues and further developments in that direction are to be anticipated

The very large number of already existing concerns and the variety of the interests affected made the emergence of a powerful central organization very difficult But their capital being inadequate, the Government felt obliged to intervene The Federal Farm Loan Act of 17th July, 1916, was intended to enlarge the supply of funds available for agriculture by creating provisions for the issue of a highly secure and highly marketable bond

The law provides for the organization of (*a*) Federal Land banks, State banks based on the co-operative National Farm Associations,[1] and (*b*) Joint-stock Land banks, the latter are

[1] This is clearly based on the Swedish example, but there are twelve central issuing institutes instead of one This is, however, merely a question of convenience, the main fact is that the bonds are uniform

private mortgage companies working under constructive Government supervision The whole system is under the supervision of the Federal Farm Loan Board The Board, composed of the Secretary of the Treasury and five members appointed by the President of the Republic, supervises the activities of the banks It appoints the Farm Loan Registrar in each district, the appraisers and examiners, and, in the case of the Farm Loan Board, three of the seven directors, the others being elected by the associations The Board may grant or refuse any specific issue of bonds, alter the rate of interest, prescribe the terms for both the loans granted and the bonds issued, etc

The States are divided into twelve districts, each with a Federal Land Bank The capital of these banks, each of which started with a minimum of $750,000, is owned by the national farm loan associations Each bank is authorized to make loans up to $25,000 through the intermediary, and, with the assistance of the farm loan associations, up to $25,000 secured by first mortgages on farm land for a period of five to forty years The banks may also buy and sell U S A bonds, borrow money and pay interest thereon, and deposit securities and their current funds with any member bank of the Federal Reserve system

The five thousand loan associations are co-operative associations of farmers organized for the specific purpose of securing credits through the loan banks Their capital stock is fixed at a minimum of $20,000, but varies with the volume of loans secured, one share being issued for every $200 loan Each member subscribes to the capital to the extent of 5 per cent of any loan he takes, the association, in turn, subscribes for an equal amount of capital stock of the Federal Land Bank of the district The members of the association are individually liable for twice their stockholdings The reserves of the associations must be invested in the bonds of the district Federal Land Bank

Loans are made only on the amortization principle, and for strictly limited purposes up to the amount of 50 per cent of

the value of improved land and 20 per cent of the permanent improvement on farms operated by the owners The farmer submits his application for a loan to the association, if the loan is approved of by the Federal Land Bank appraiser, the association endorses the mortgage over to the bank, thus assuming a secondary liability for the payment of the bond, and deposits loan bond capital stock to the amount of 5 per cent of the loan with the Land Bank as partial collateral security for the loan The bank advances the funds It then deposits its mortgages with the Registrar as collateral for the bonds which it issues under specific authorization of the Board Each bank may issue and have outstanding bonds to the extent of twenty times its capital and surplus The bonds are the obligation of all Federal Land Banks jointly, they are lawful investments for trust funds and may be accepted as security for all public deposits They are also free of taxes Since the investments of these banks are necessarily placed in first rate real estate mortgages, and since, for the system as a whole, these mortgages are drawn from every part of the country, the risks undertaken by the system as a whole are very widely distributed

The Joint-stock Land Banks have as their purpose the placing of private mortgage business on a more efficient basis, and they are an essential part of the new system The scope of their business and the regulations relating to it are the same as for Federal Farm Land Banks, with the following exceptions

They differ from the Federal Land Banks in five important respects (1) The capital stock, of which at least $250,000 must be subscribed, is owned privately The total capital for the forty-eight banks[1] (not including the three banks in receivership) in 1930 amounted to $41 7 millions (2) Loans are granted directly to the applicants (3) There is no joint responsibility among these banks, each is liable individually for

[1] Since the passing of the Federal Farm Loan Act, 80 such banks have been chartered, but liquidations and consolidations have reduced their number.

its own bonds and other obligations The bond issue is limited to fifteen times the capital plus the reserves (4) Each time that a loan is made by a Federal Land Bank its capital stock is increased to the extent of 5 per cent of that loan There is no such continuing increase in the case of the Joint-stock Land Banks (5) The officers and directors of the Federal Land Banks are appointed by the Farm Loan Board, while the officers and directors of the Joint-stock Land Banks are elected by their stockholders

In other respects they operate in a manner similar to the Federal Land Banks Funds are obtained from the sale of tax-exempt bonds, and the operations of the bank, the fixing of the rate, the accumulation of reserves, etc, are under the control of the Board

The Government's efforts to reduce the charges on real estate credit have been successful Indeed, so heavy has been the decline in the rates obtainable on American farm mortgages that some of the funds of British mortgage companies have been withdrawn and placed into investment trust companies As late as 1925 the rate ranged from 5½ to 9 or 10 per cent according to the locality

Subsequently, numerous private joint-stock land banks were established doing similar business They, too, are under the supervision of the Federal Farm Land Board, and between them may be regarded as constituting the most important part of the organization of agricultural real estate credit in the U S A

At the close of 1930 the Federal Land Banks had granted loans amounting to about $1,653,000,000 to over 300,000 farms, whilst the private joint-stock banks of the Federal Farm System had granted loans exceeding $800,000,000 The total of Federal Land bank bonds outstanding was $1,186,000,000, the total of joint-stock land bank bonds outstanding amounted to $550,000,000

The frequent temporary fluctuations in land value and the type of building constructed make the problem of granting real estate credit somewhat different from that in France and

Germany, and in other European countries where land prices vary less and have shown for the last century a fairly steady rise This is partly the cause of the number of clear distinctions which may be drawn between the mortgage bond system of America and of Europe

The credit bodies developed before 1917 are still in existence, although greatly influenced by the Federal Farm Loan organization In all the other countries under a regulated system the regulations are, as a rule, compulsory and universal, i e a bank is granted permission to issue bonds only on the condition that it complies with the rules, but in the U S A the banks may or may not submit to the system Most mortgage credits are still financed directly, and without the use of bonds No co-operative mortgage associations have emerged[1]

While an organization, combining the advantages of a centralized bond issue with a decentralized apparatus for granting credits, now provide for agricultural needs, no special provisions were made for City real estate credit This has grown to enormous magnitude The modern building is a project of big proportions requiring the investment of many people During 1924–1929 some $10,000,000,000 of new buildings were added on sites valued another $2,500,000,000 Individual owners and entrepreneurs found one-fifth of this amount, the remainder—in some form of security—came from the banks or the investing public

Small dwellings in the cities are financed on the basis of

[1] The grant of long term loans is a simpler business when the owner farmer applies for it than when it is desired by the tenant farmer In recent years, however, tenancy has been on the increase In 1880, 74 5% of the farm land was occupied by owners, in 1910, only 62 1% There are various reasons for this the strong drift towards the cities, which puts farms on the rental market when they cannot be advantageously sold, the necessity, as soon as free land disappeared, of allowing men without capital to rent their land for a period before purchasing it, the letting of land on a share or money rent to white or coloured people in the plantations of the South The object of recent legislation, such as the Federal Farm Loan Act of 1917 and the Agricultural Credits Act of 1923, is to arrest the growth of tenancy by lightening the cost of land owning and rescuing the cropper tenant of the South from bondage to the middleman

mortgages for small amounts granted by the building and loan associations from funds originating in the savings of the lower middle classes [1]

Like the private farm mortgage bond, the bond used for financing City real estate credit is, in many States, not subject to adequate Government regulation It is for this reason, perhaps, that there has been such a lop-sided growth of specialized building mortgage bonds These are, as a rule, not the obligation of a mortgage company secured by a group of mortgages, they are secured by a single mortgage and are the direct obligation solely of the owner of that property There is a separate bond issue for each piece of real estate financed, whether an apartment house, office building, or theatre This bond usually runs from two to twenty years, and is, as a rule, secured by redemption fund provisions, so that indebtedness is retired at maturity At the present time this type of bond makes up over 80 per cent of all the urban real estate mortgage security issues publicly advertised for sale Currency is given to them because they are underwritten and sold by a well-known real estate bond house or by an investment banker Some 600 mortgage companies issue bonds of the European type, i e they are secured by a parcel of diversified mortgages, but only a few of these borrow in the central financial markets Both types of company, those with a diversified and those with a single security are small compared with the European mortgage banks None have a share capital of over $5,000,000, or a bonded indebtedness of over $40,000,000

The absence of legal devices of a protective nature for the bonds of issuing companies has resulted in special measures being developed to confer on their bonds additional security These reveal at the same time their inherent weakness The bonds could not be brought on the market without the additional guarantee or the endorsement of a guarantee company This company either guarantees the payment of principal and

[1] There are altogether 12,666 building and loan associations in America, with total assets amounting to more than £1,600,000,000 For a good account of their development and activities, see Moulton, *The Financial Organization of Society*

interest when due on each underlying mortgage, or endorses the certificates issued for a charge of about ½ per cent The three or four large surety businesses are able to guarantee payments on a diversified list of mortgage bond indebtedness By selecting their risks carefully, by distributing them according to localities and according to their industry, they are able to insure against the losses resulting from default by certain companies The surety guaranteed is obviously valuable under the present chaotic conditions, but is not regarded as a fundamental remedy against the lack of security It is contended that institutions with abundant resources and conservative standards able to lend on a scale commensurate with the size of the mortgage loan market of the country and working under governmental supervision, Federal preferably, are needed They would be able to issue bonds satisfactory from the point of view of marketability and of security.

This issue of bonds against the deposit of a single mortgage is opposed to one of the fundamental principles of real estate credit the diversification of risks Appraisals ought at least to be made on a more conservative basis It is suggested that the net income from the property ought to equal at least twice the interest and amortization charges But during the recent boom in property in the U S A the speculative promoters of buildings have issued first mortgage bonds up to nearly 100 per cent of the original cost of the enterprise Changes in the neighbourhood, fluctuations of the business cycle Stock Exchange crises, immediately affect the value of this type of bond The bulk of these bonds are sold by a few large houses specializing in these securities The issues sold by them are retired, as a rule, in 10 years or less, but there is a considerable amount of 12–15 years' bonds They are callable usually at a premium Only the old investment houses doing general business have a considerable amount of bonds of the sinking fund type

These bonds are the least secure mortgage bonds to be found anywhere The security of one building, the high proportion of the total value issued as bonds, the lack of sinking

fund, and the absence of supervision are sources of weakness But the failures are not as great as might have been expected While nearly all the underwriters of real estate issues refuse to assume any legal liability for the payment of principal or interest, most houses whose business is dependent upon their reputation maintain payments to the bondholder in case of a default by the borrower The number of bonds in one issue changing hands from time to time is too small for close quotations or an active market, few issues are listed on the Stock Exchanges Even if they were, the market would still retain much of its present dependence upon the support of the issuing house

The uniformity of the various issues of any one underwriter is partly due to this practice followed by nearly all underwriters of supporting the market for their own issues so as to avoid fluctuations

Within the past twelve months a special mortgage bond exchange has been established If this is allowed to develop gradually the situation may be improved very considerably [1]

A new type of bank is slowly emerging in the United States A bank which deals with land and takes deposits and grants loans in connection with it The desire for loans is, of course, there The real difficulty lies in acquiring the capital from investors To-day, the lender takes a bond on a property about which he knows little and, in effect, relies on the good name of the banker In future the banker may simply guarantee him, say, 6 per cent He may be able to take a forty year loan or deposit at 6 per cent, which may or may not be in the form of a bond, if he disposes of it at the same time for the same sum plus an amount for administrative expense, insurance against risk, and a fair profit

In the U S A the yield on real estate loans ordinarily exceeds the yield on bonds by about 1 per cent This may be explained in part by the cost of handling, and in part by the lesser marketability The administrative expenses on the former are higher Real estate mortgages require careful and

[1] See Chapter IV

frequent appraisals, examinations of title, and supervision of insurance policies. This costs about ½ per cent, even when the sums involved are large. The customary rate for mortgages being 6 per cent in the U.S.A., the net return will be 5½ per cent as against, say, 4.9 per cent on other classes of investment. Six per cent is paid for the difference in marketability, assuming that the security of high-grade mortgages and industrial bonds are alike. The development of a nation-wide market would, it is expected, result in lowering the yield of mortgage bonds by at least ½ per cent.

CHAPTER XII

GREAT BRITAIN

THREE major facts were always pointed to as grounds why there was no need in Great Britain either for special mortgage banks, such as the Crédit Foncier de France or the Federal Farm Land Banks, or for the development of mortgage bonds, or for State subsidies to encourage the organization of capital for long time loans on farming property. These were the system of land holding, the availability of capital for all remunerative undertakings at reasonable terms, and the particular friendliness of the banks to borrowers on real estate. Were these reasons sound? Broadly, the land was owned by large proprietors who not only let it to farming tenants, but also provided for the major expenditures for permanent improvements, i.e. for buildings, drainage, and fencing. The farming tenants were free to use their own capital on cattle, seeds, labour, etc. This opportunity of using their resources for farming operations made English farmers desire undisturbed possession rather than the full ownership of land sought in France and in Ireland. The landlords did their duty well, so that Great Britain became a country of tenant farmers. It is estimated that whilst in 1910 about 10 per cent of cultivated England and Wales was worked by its owners, in 1925 this rose to 25 per cent. This was due to the purchases made immediately after the war. Owing to their being men of substance, it was argued that both landlord and tenant could borrow at comparatively low rates, both for long period and short time loans. The big banks were always able to demonstrate that in point of fact they lent colossal sums to farmers, and that although they preferred to grant loans for short periods, they were ready to renew them. The recallable loan, recoverable within a few weeks, was not, however, in spite of that fact, likely to be very popular with borrowers.

It was true that direct negotiation between borrower and

lender and more organized lending by solicitors who had their clients' funds to dispose of still supplemented the loans granted by these institutions. However, the farmers were not at all persuaded that all was for the best and, in spite of their demands, nothing was done to help them to obtain capital more easily until the changed conditions after the war demanded special measures. These changes resulted from the heavy financial losses incurred by the land-owning classes between 1914 and 1928, in part owing to the inflation and deflation processes which led in many cases to the lessening of their capital, in part as a result of the rise in prices whilst their incomes remained relatively stationary, and in part owing to the additional burden of taxation. Other factors which had an adverse effect on the landlords and farmers were the relative decline in the price of farm to other products, the long periods for which rents were fixed and their relative inelasticity, and the rate and the terms on which loans are granted. The annual national surplus for investments was less, and the competition for its use made by industry was greater. The effect of these conditions in Great Britain, as elsewhere, was the break-up of great estates at an accelerated rate. With the land-holding class less able to provide for the financing of the farming industry than it had been previously, private enterprise was regarded as inadequate to meet the situation. But in spite of these conditions the agriculturists did not turn to co-operation with any enthusiasm. Their lack of associated effort in the more elementary tasks of marketing made it seem unlikely that they would co-operate in order to obtain capital cheaply.

The various causes which called for legislation in favour of agriculture after 1921 have been summarized as follows[1]—

1 The world depression in trade and the fall in the price of agricultural produce after 1921, which rendered farming under existing conditions unremunerative.

2 The fact that during and immediately after the War many

[1] Dr L Le M Minty in *The Economic Journal*, June, 1930, pp 249–258.

farmers had agreed to purchase their farms at what turned out to be top prices

3 The repeal by the Corn Production Acts (Repeal) Act, 1921, of the Corn Production Act, 1917, which by removing the bounties on home-grown wheat let in foreign wheat in competition with home-grown grain

4 The fixing of farm labourers' wages, under the Agricultural Wages (Regulation) Act, 1924, by committees at rates which in many districts made it impossible for farmers to cultivate less fertile land with any hope of profit

5 Traders and merchants were equally hit by the same adverse circumstances, and could no longer give extended credit in respect of seed and agricultural machinery bought

6 The refusal of the electorate to give the Conservative party a mandate to impose protective duties on foodstuffs

7 After 1926 the burden on former copyholders to pay compensation to the lords of the manor for enfranchisement of copyhold land under the Law of Property Act, 1922

For these reasons the Government was at length induced to grant aid to agriculture under the provisions of the Agricultural Credits Act of 1928 The chief result of this was to be the organization of the Agricultural Mortgage Corporation with a capital of £650,000, to whom the Government was to lend an equal sum for 60 years without interest With this £1,300,000 as a basis, experience in other countries shows that loans of twenty times this amount could be made safely against first mortgages on land, so that there would be made available in the course of time, say, £26,000,000 for long time loans to land [1] It was to receive, also, a subsidy of £10,000 a year towards its upkeep for a period of ten years

[1] Half this amount if the Government guarantee is not used as a basis The Act provides that "the aggregate amount of Government loan and 'marginal fund'" (consisting of paid-up capital and amount standing to reserve, including special reserve) shall never be less than 10% of debentures outstanding, except that if such outstanding securities shall exceed £50,000,000, and so long as the "marginal fund" is not less than £5,000,000 limit an amount of such outstanding securities shall be increased by £1,000,000 for every £75,000 of the "marginal fund"

The Agricultural Mortgage Corporation was formed for the purpose of making loans on first mortgage of agricultural or farming estates, and the principal assets of the company consist of mortgages or securities in respect of the loans granted The subsidy given to the Corporation is the interest accruing from the investment of £650,000 obtained from the Minister of Agriculture and Fisheries in British Government securities for a period of sixty years, after this period the Corporation will pay 5 per cent on the capital The interest of the early period is to constitute an additional guarantee for the stocks issued In brief, the indirect subsidy amounts to £32,500 per annum for thirty years Its funds being limited to £650,000 share capital and a similar amount loaned from the Government, the Corporation came on to the market in June, 1929, with a £5,000,000 issue of debenture stock This debenture loan, which is guaranteed by the Government, gives a full 5 per cent yield over a minimum period of thirty years It is to be redeemed not later than 1989, although the Corporation has the option of redeeming it at par on or after 1st July, 1959 Redemption is to take place by the operation of a cumulative sinking fund of ½ per cent per annum, commencing in 1939 and applied by purchases for cancellation at or under par

The Corporation reserved the power to issue further stock and other like securities either in one or several series ranking *pari passu* in point of charge with the stock now issued Since most of the debenture capital had been already loaned, a second issue was made in 1930 of an additional £3,500,000 debentures on the same terms as the previous issue The valuations of the properties comprising the security for the mortgage loans made up to 30th March, 1931, totalled some £10,000,000, the amounts loaned on mortgage were some £7,000,000 on 2,350 mortgages, improvement loans were £19,000

It would be interesting to learn to what extent the mortgage corporation loans represented new borrowing or merely loans transferred from the ordinary banks to this new institution The Corporation paid 1½ per cent for the underwriting

of the first issue This was a wise precaution, seeing that the underwriters were called upon to take up about 85 per cent of their obligations They were soon able to dispose of them as the price quickly rose above parity They were in the rare position of pocketing a double profit These debentures secured by first mortgages are essentially the same as mortgage bonds of the continental type This machinery enables the Corporation to tap some of the annual amount available for investment in a manner to which the market is accustomed The security is bought widely by all seeking a gilt-edged security —whether powerful insurance companies or small investors The management of the Corporation is in the hands of nine leading bankers who are also shareholders [1] But their profit is limited to a dividend of 5 per cent on their capital The borrower can arrange for his loan in the branch office of any of the large banks Apart from the 5 per cent to the investor in the debentures and to the shareholders, the scheme aims to give the farmer all the benefits possible

The registration of mortgages in a Land Register has become compulsory in certain parts of the country since 1926. But whilst there exists a developed mortgage law, and the mortgagee has rights of quick and cheap execution on default in payment, there is no Cadastre of the French type nor Grundbuch of the German type

The development of real estate credit in the urban areas has been greatly influenced in the past by the fact that the ownership of large blocks of land in the centre of the chief towns of the country was in a few wealthy hands. In view of high taxation and the sale of estates this state of things is not likely to endure without considerable modification Generally, it is the smaller property owner who wishes to borrow on mortgage, and as the large urban holdings are split up this need is likely to grow One of the chief obstacles to the development of the mortgage bond as a means of financing urban real estate credit was the prevalence of the landlord and lease system This, as we have seen, need not

[1] Except the Midland Bank amongst the large banks

have been the case In this field, also, it was too easily assumed that capital was available whether it was so or not This optimistic view proved fallacious in respect to the task of providing working-class and middle-class houses and other building works after the War The Government and local authorities had to provide some £35,000,000 during the period 1924–1928 in subsidies Municipal banks, public utility societies, insurance companies, trustee savings banks, co-operative housing societies, friendly societies, all had to divert their interest and funds into this field But easily by far the most important effect of the lack of capital for this purpose has been the great development of the building society movement

The Building Society[1] is the nearest approach in this country to the continental urban mortgage bank Although its operations interest a considerable body of large and small investors it is, unlike most securities, outside the sphere of the Stock Exchange Building societies in the same way as the mortgage banks provide that, whilst millions of capital are locked up, a stream is always flowing, bringing in new investments and debouching repayments and interest Like so many other movements of the lower classes, it has its origin and early development in the North of England, but in recent years has become equally strong in the South and, indeed, has been copied in a large number of other countries

Early in 1929 there was something like £269,000,000 invested in the building societies of England and Wales, and in the course of one year the sums mounted up to something over £340,000,000 In the year 1929 alone, when the deposits of the English joint-stock banks declined by £38,000,000, and the total emissions of new capital in London fell off by £84,000,000, the advances made on new mortgages amounted to £70,000,000 This compares with £59,000,000 in 1928 and £52,000,000 in 1927 There are about 1,000 societies, of which

[1] The early development of building societies made the necessity for mortgage banks less urgent in this country On the Continent the mortgage banks came first and the building societies were established later Birmingham claims to have established the first building society, in 1781

forty are fairly large, i e with assets of more than £1,000,000 It is anticipated that an era of amalgamation is in store for these societies

The following table shows the progress made by three representative institutions—

		000's omitted		
		Halifax[1]	Abbey Road	Leeds
Due to shareholders (excluding interest)	1927	37,160	7,042	6,143
	1928	44,517	11,338	7,015
	1929	49,377	16,885	7,999
Due to depositors (excluding interest)	1927	8,360	767	2,033
	1928	7,949	612	2,676
	1929	8,000	1,185	3,340
Total mortgages outstanding	1927	38,763	7,578	7,853
	1928	40,571	10,897	8,827
	1929	44,783	18,010	10,626
Total assets	1927	46,981	8,252	8,728
	1928	54,155	12,585	10,174
	1929	59,394	19,167	12,002

[1] For 1927 and 1928 the joint results are given of the Halifax Permanent and the Halifax Equitable, now merged in the Halifax Building Society, the biggest building society in the world

See *The Economist*, 15th March and 22nd March, 1930

There are in all some 2,000,000 shareholders, excluding depositors The individual society borrows from the public Its assets constitute the security Investment in building society shares is ideal for the small investor He obtains a yield of, say, 5 per cent[1] net on shares, withdrawable at comparatively short notice without loss, income tax being paid by the society usually at a "compounded" rate of 1s in the £, whilst he obtains only 2½ per cent from the Post Office Savings

[1] In 1931 the building societies have given notice that larger depositors are to receive in future only 4½% tax free

Bank, and only £4 2s 9d per cent from National Savings Certificates if he leaves his money untouched for ten years It is almost 1 per cent higher than can be obtained from gilt-edged securities The building societies aim at paying rates of interest which are more stable than the general rates This well-secured investment involves no brokerage or taxation and carries no risk of market depreciation It is therefore increasingly attracting also the middle-class and comparatively wealthy investor, whose interest is aroused in part by the effective advertisement of their facilities The average investment in a selected group of societies is £228, but as has been suggested by the Committee on Municipal Savings Banks, "In any savings bank four-fifths of the deposits are in one-fifth of the accounts" Applying this law to building societies, a substantial number of investors own investments of more than £1,000 In 1929 there were more than 1,250,000 share investors and 395,000 depositors The borrowing members are mainly persons of moderate means Some 82 per cent of loans are in respect of mortgages on which not more than £1,000 was outstanding, the average debt in this group was £372, whilst the average in the remaining 18 per cent was £1,844 [1]

The society lends on the security of property, as a rule, on the houses of lower middle-class proprietors living in the houses they desire to mortgage at about 1 per cent higher than it pays The making of advances on long term mortgage is a specialized business involving risks which cannot be entirely eliminated But the large building society enjoys advantages of administration, since uniform principles are applied to all applications for a loan It is able to employ the best ability and its officers obtain the greatest experience It builds up a technique and tradition Borrowers are carefully chosen, the percentage advanced is restricted to 80 per cent of the value of the property and amortization is required,

[1] The London societies pay a higher rate of interest to shareholders and to depositors and charge a higher rate to borrowers than the provincial organizations Some of the former also pay a commission of up to 1% of the principal of the mortgage for the introducion of business

so that payment is completed, as a rule, in fifteen years Moreover, the large range of small transactions gives a stability of risks, resulting from the different areas, occupations and circumstances of their clients, which no investment trust company could ever hope to obtain On the other hand, each individual borrower feels that he has special expert attention paid to his individual valuation and risk In 1929, 635,000 persons were in the process of buying their houses by the aid of these societies

The extremely low ratio of defaults is striking It is even less than those on mortgage bonds The following table shows the proportion of mortgages foreclosed on upwards of twelve months in arrears, in proportion to the total outstanding for the three societies already mentioned—

	No of Mortgages Outstanding	No in Possession or over 12 Months in Arrears	Amount of Mortgages Outstanding	In Possession or over 12 Months in Arrears	
				Amount	% of Whole
Halifax	118,560	None	44,783,000	None	—
Abbey Road	30,260	None	18,010,000	None	—
Leeds	23,030	1	10,626,000	16 25	0 015

The Woolwich Society shows that arrears constitute 0 103 per cent of the total Building societies have more than doubled their assets in the last six years They now absorb about one-tenth of the nation's annual saving One-fifth of the population are living in houses obtained with their aid

It may be doubted whether they will be able to continue to find for very many years equally safe new mortgage investments—a problem which has begun to worry also the German mortgage banks If the normal demand for housing, the clearing of slums, and the improvement of existing property do not give them sufficient scope for their activities, will they turn their attention to providing industrial mortgages or to

municipal loans, or will they look to wider investment trust activities?

It is clear that in England large property owners do *not* enjoy the advantages of a mortgage bank which grants credits on the security of industrial property [1] The establishment of the Bankers Industrial Development Company, which has the same chairman as the Bank of England, might consider, in the pursuit of its policy of financial assistance to industry, the desirability of exploiting this device An industrial mortgage bank on the lines of those in Germany, Finland, and Hungary might be developed as a separate institution Or, again, the device could be adopted by the development of a special department to our deposit banks They might borrow funds from the community for a definite period, five, ten, or twenty years at a fixed rate of interest Bank bonds could be issued against these loans, and they would become a recognized Stock Exchange counter The banks with their special machinery of expert advice status information, and ability to distribute their risks, could then lend with comparatively little risk

Certainly, it would seem that there is a gap in the financial machinery of the country in the absence of a mortgage bank for real estate of greater value in the towns It is true that other machinery does exist But this part of their work is treated as subordinate and indirectly, instead of enjoying the importance it merits for its own sake, and directly Nor is it clear that the existing institutions do actually give sufficient credit for this purpose

There is a considerable and growing number of well-established companies interested in investment in city real estate They aim to bring the security of real estate and the attractive rate of interest obtained thereby within the reach of the average investor to whom these advantages would otherwise be unattainable The existence of several old-established concerns already managing various properties on a more or less

[1] The view that existing facilities are adequate is strenuously divided by groups of business men

large scale seems to show that the business is a safe one, although newcomers occasionally do not reach the average standard [1] They are concerned largely in purchasing property and sub-letting parts as flats or offices or shops But this form of investment is not very commonly undertaken by companies in England, in part because mortgage loans are more readily available in small rather than in large amounts It is noteworthy that these securities depreciated comparatively little during the recent Stock Exchange slump, and, indeed, it was remarked that in the industrial share list those securities depreciated least whose major tangible assets were in the form of business premises Insurance companies, and occasionally trusts, frequently revert to mortgage securities in preference even to gilt-edged stock for this reason Certainly, because of recent bad experiences with investments in other fields, building societies have grown enormously in popularity The device of mortgage bonds is not employed, nor are there any mortgage banks, but similar devices have been adopted and the same functions carried on under different names

Insurance companies are very ready to lend money on mortgage to their policyholders, and in the post-war period during the housing shortage many people took out insurance policies in order to be able to borrow sufficient to build themselves a house [2] But freeholders are reluctant in this country to mortgage their property in order to obtain capital for their business

The solicitors who have long had a vested interest in this field have not been content to let the insurance companies and the building societies and the real estate companies take the business from them Rather have they perfected their own organization to use these new institutions At the same time they keep as much of the business as they can for themselves They have established a clearing-house for solicitors,

[1] The Westminster City Properties, Ltd, a company formed in 1928, with a capital of £500,000, was so badly managed that four of its directors were impelled to resign by the end of 1929

[2] The returns of insurance offices of the Board of Trade for 1927, showed that British companies owned invested funds exceeding £1,000,000,000 It is estimated that £375,000,000 is invested overseas

in fact there are two, so that those having clients who wish to borrow on mortgage shall be put into direct contact with those having clients who wish to lend on mortgage It is the large property owners who have the greatest difficulty in obtaining long period loans on the basis of their security

Foreign mortgage bonds are issued on the London market from time to time, and are generally taken up by the insurance companies and investment trusts There is no active market in them, and, indeed, few stockbrokers could give much information about them There are actually quite a number which are traded in on the London Stock Exchange, but as they are listed under different heads, under Governmental, Industrial, and Banks, their special identity is ignored Had the Agricultural Mortgage Corporation assumed the name of a bank, and used the term mortgage bond instead of debenture, it would probably have stimulated interest in this type of security

One of the functions of the continental mortgage bank is, as a rule, the grant of communal loans against the issue of communal bonds or mortgage bonds A centralized bank like the Crédit Foncier de France is, as we have seen, able to achieve considerable economies in providing such loans for all the smaller municipalities and local authorities Compare this situation with that prevailing in England Amongst the municipal loans offered in London during March and April, 1930, were the following—

March	8th	£1,650,000	Southampton	5% Stock 1947–67 at 99
,,	17th	£1,500,000	Swansea	5% Stock 1945–55 at 99
,,	24th	£2,500,000	Bristol	5% Stock 1950–60 at 99½
April	4th	£ 500,000	Belfast and District Water Commissions	5% Stock 1950–60 at 99½
,,	9th	£1,000,000	Barnsley	5% Stock 1950–60 at par
,,	9th	£1,000,000	Sunderland	5% Stock 1950–60 at par
,,	24th	£ 800,000	West Ham	5% Stock 1946–68 at 98½
		£8,950,000		

These seven municipal loans were offered at prices ranging from 98½ to 100½ per cent within this limited period Clearly there is expense and waste in seven separate issues of this kind

The London County Council finances the metropolitan boroughs from its own borrowings, and charges them about ¼ per cent to cover its expenses The local loans fund makes loans to municipal authorities through the issue of stock, and, although its activities are restricted in many ways, over £25,000,000 a year on an average are advanced through it

It is suggested that a central borrowing authority, making large issues at suitable times, and relending at cost plus administrative expenses to individual borrowers, would result in large economies to many local authorities Such an authority might take the form of a State-recognized institution for municipal credit, such as the Spanish Bank for local credits, or it might be formed by the municipalities on a co-operative basis The "Liberal Industrial Inquiry" recommended that a Board of National Investments should take over the functions of the National Debt Commissioners and of the Public Works Loan Board, and it should be authorized to issue national investment bonds having a Government guarantee It advocates that new capital expenditure by all central, local, and *ad hoc* official bodies should be financed out of this pool This proposal differs from the others only in the nature of the security offered for the loans

The consolidation of all loans raised by a local authority into one fund has been a feature of the financial organization of certain British municipalities for many years The proposals would tend to consolidate the loans of a number of local authorities

The Crédit Foncier acts in addition as the Central Mortgage Bank for the French Empire A project has been outlined for establishing an Imperial Mortgage Bank for the British Empire

This survey shows that in the absence of special machinery for lending on the security of first mortgages, such as exists on the Continent in the mortgage bank operating through the mortgage bond, a series of special *ad hoc* institutions have been developed Since the War the founding of the Agricultural Mortgage Corporation and the great extension in the activities

of the building societies have done much to fill the gap, but there are still lacunae and consequent complaints [1] The building societies might use its surplus funds to fill them

[1] British building contractors complain of the lack of facilities for long time loans for constructional work They argue that whilst British bankers rarely lend on any but a pure banking basis, French, German, and American banks support engineering projects with both "finance and diplomacy" They are considering the possibility of a solution along the lines of establishing purely "trade and insurance banks" in order to be able to obtain builders' mortgage loans

CHAPTER XIII

NOTES ON VARIOUS COUNTRIES

THE Scandinavian countries have comprehensive systems of mortgage banks granting loans on both agricultural and urban real estate While the banks of Norway and Denmark work on a competitive basis both in bond issue and in loans, Sweden, as we have seen, has developed the centralized issuing type of institute The bonds enjoy the advantages of the sound credit conditions of these countries, so that they can borrow in their own markets as well as abroad at very low rates The State has taken an active part in the development of these banks

Denmark.

The Danish Mortgage Bank System is characterized by the great importance of the co-operative organizations The land credit associations, established shortly after the law which governs them was enacted in 1850, are patterned after the new German Landschaften Some of the associations differ from the German type in so far as they grant long term loans secured by first mortgages not only on rural but also on city real estate, others are restricted to urban or rural credit exclusively In one instance long term mortgage credit on industrial property is given Loans up to one-third of the value may be granted without amortization, the limit for amortization loans is three-fifths of the appraised value The bonds issued are free from stamp duties, and constitute a legal investment for trustees' funds The bonds of the Credit Association of Landlords in Copenhagen and its surroundings, and of the Credit Association of Proprietors of Small Landed Estate in Jutland and the Islands of Denmark, are quoted on foreign markets

A special feature of the Danish organization is the issue of bonds against second mortgages by land credit associations

In spite of certain legal privileges granted them they are not favourably regarded by the market

In 1906 the Mortgage Bank of the Kingdom of Denmark was founded to act as a central agency for Danish real estate mortgage institutions which grant credits to real estate owners and public bodies The Bank purchases certain specified bonds and, in turn, issues its own against them as security on the home market or abroad They are guaranteed by the Government, and are eligible for trustee funds The entire capital stock, amounting to Kr 20,000,000, is owned by the Government, which takes part in the administration of and supervises the Bank It is estimated that in the rural communes debts amount to one-half of the value of the land

Norway.

Norway has a competitive regulated mortgage credit system in which the co-operative principle has considerable scope The Government has taken a very active part in the development of mortgage banks

The Royal Norwegian Mortgage Bank was established in 1852 The Government, which supervises the bank, furnished Kr 40,000,000 of the total foundation capital of Kr 57,000,000 The Bank grants loans up to 60 per cent on rural, and up to 40 to 50 per cent of the appraised value on improved city, real estate No loans are granted on plants or buildings which are not insured The Bank may also grant credits against bonds issued by certain mortgage associations It may issue bonds to an amount equal to eight times the foundation capital, these bonds are guaranteed by the Government, and are a legal investment for trustee funds In 1927, the total of loans granted was Kr 400,000,000, the total of loans outstanding being Kr 440,000,000

The Agricultural Properties Bank was established in 1903, with a capital of Kr 5,000,000 contributed by the Government with the purpose of financing labourers' holdings and dwellings by long term amortization loans The total of bonds in

circulation must not exceed six times the capital stock These bonds are guaranteed by the Government

The private mortgage banks and co-operative associations which issue their bonds on the home market are chiefly concerned in financing agriculture But loans may also be granted by co-operative associations on industrial plants up to 50 per cent of the value of the property

Sweden.

In Sweden a legal monopoly has been granted to the Imperial Swedish Mortgage Bank for the issue of bonds on agricultural land, whilst the Swedish Urban Mortgage Institution has a virtual monopoly in the issue of bonds on urban real estate The land credit organization is on a decentralized basis Ten provincial co-operative mortgage institutions give credit, which they borrow from a central institute, on first mortgages on cultivated agricultural land, while city real estate is financed by special local mortgage banks which obtain credit, as a rule, from another central institute

The strong competition of the landowners' associations when issuing their bonds on the market led, in 1861, to the foundation of the Imperial Swedish Mortgage Bank, whose activities are now regulated by the Act of 1890 The Bank was endowed with the exclusive monopoly of issuing bonds secured by agricultural real estate The object aimed at was the issue of a unified marketable bond The Bank has no share capital, the Government subsidy of Kr 30,000,000 5 per cent Government bonds is used as a reserve fund Very few restrictions are imposed in regard to the granting of loans, there is no fixed relation between the fund and the amount of bonds issued The Bank grants loans to the district associations which act as intermediaries and, in turn, hands over to the central institution the mortgages of their members equal to the amount of the loan they receive The credit granted by the associations must not amount to more than half the value of the land serving as security in the case of amortization loans, and in the case of loans without provision for amortization to

not more than one-third The price at which the Central Bank obtains capital on the market is charged to the associations with a small addition for administrative expenses and a reserve fund All profits are used for reducing the charges of the borrowers or are placed in the reserve, which will enable an ultimate lowering of the interest rate The total of loans advanced by 1925 amounted to about a thousand million kroner, of which about two-thirds had been repaid or amortized The reserve of the central institute need not be large because of the security of its bonds which have not merely the mortgages as cover, but also the joint liability of the credit associations and their members up to the amount of loans outstanding These well-secured bonds, issued in large numbers to satisfy the requirements of the associations, came early on to the foreign markets Rural mortgage indebtedness is between 40 and 50 per cent of the rated value

Besides the Empire Mortgage Bank and its associated rural mortgage societies, there have been established mortgage banks organized as private joint-stock companies for lending on urban property, the earliest of which dates from 1865 An attempt made to organize the Imperial Mortgage Bank at its foundation to enable it to grant also urban credits failed because the conditions of town property were not then regarded as sufficiently stable In 1909, however, the local town associations, assisted by the Government to the amount of Kr 50,000,000 in Government bonds as a guarantee fund, succeeded in organizing the Swedish Town Mortgage Institution, which centralizes the bond issue for them and enables them to obtain cheap rates This central bank of issue for urban real estate credit has not an absolute monopoly, and is bound by stricter regulations than the agricultural bank It may issue bonds only up to ten times the reserve funds, and grant loans without provision for amortization up to 37 per cent of the value of the property, and amortization loans up to 50 to 60 per cent Borrowers received their loans in the form of the bonds of the Town Mortgage Bank

Both agricultural and city real estate banks, with the

exception of the Mortgage Security Company of Stockholm, conducting a general banking business in addition to the business of mortgage loans, belong to the type of pure mortgage banks, and in organization and business activities are very much like the German mortgage banks

From being a borrowing country previous to the War, Sweden has since become a lending country and can, thereore, easily absorb her own new mortgage bond issues But, in fact, the Imperial Mortgage Bank and the Town Mortgage Bank being semi-State institutions and being State-aided, they have placed some of their bond issues in France and Switzerland on very favourable terms There has been no special need for an industrial mortgage bank since the Swedish banks finance industry perhaps more than any other country in the world Besides taking a direct interest in industry, the Swedish banks like the American trust companies, "the department stores of finance," perform banking, fiduciary, agency, and investment functions [1]

Holland.

Dutch mortgage banking, like its general banking, is characterized by the large number of small joint-stock institutes, and by the fact that the issue and business of mortgage bonds is left without any special restriction or State control Companies engage in this business without obtaining the stimulus of a State subsidy on the one hand, nor are they limited by regulations on the other

Mortgage banks financing their loans through the issue of mortgage bonds began to grow up about 1860, and there are to-day some sixty institutes, most of which are very small They generally provide five to ten year loans on city real estate, although they occasionally provide also loans for longer periods which have the usual amortization features Agricultural credit is financed chiefly by agricultural co-operative institutes not issuing bonds Only two banks have specialized

[1] *Foreign Banking Systems*, p 1035

in this business, the Boerenhypothekenbank and the Nordhollandsche Groundcredit The life insurance companies and savings banks also provide rural and urban credits

Bonds issued by the mortgage banks differ from German and French bonds by the lack of the additional security resulting from special legislation and Government supervision But the banks themselves after a crisis in 1905–1906, which resulted from the abuse of the power of free issue by some of them, voluntarily limited the amount of bonds in proportion to their capital and reserves Moreover, the Postal Savings Bank has become one of the largest purchasers of this form of security, and is in a position both to judge the merits of the policy pursued by the banks and to give a lead to other purchasers It restricts its purchases to the bonds of banks which have been established at least ten years, have a minimum bond issue of Gulden 10,000,000, as well as a certain minimum reserve The formal differences between them and the German and French bonds are, therefore, greater than their real distinction But the short period of the loans, the lack of the safeguards granted by the regulated systems, and the competition for available capital, makes the interest asked for bond capital high Dutch bonds lack marketability, both because of their characteristics and their limited issue To make their bonds more attractive certain banks offer extra inducements, such as a right to participate in the annual profits of the bank The subscribed capital of the principal Home Mortgage Banks is about Fl 80,000,000, of which 16 per cent has been paid up Their surplus funds were double this amount The total of bonds outstanding is about nine times the subscribed capital Dutch capital has been very interested in financing foreign real estate The reputation of Amsterdam as the central Stock Exchange for mortgage bonds is due to its interest in all the leading central European issues, and to the considerable number of Dutch Colonial and Dutch foreign mortgage banks [1]

[1] A E Davies, in *Foreign Investments*, over-emphasizes the importance of Amsterdam as a market for mortgage bonds, because, in spite of the long list of securities of this type, dealings are not very frequent

In 1883 the Nederlandsche American Mortgage Bank was formed with the purpose of granting loans on U.S.A. and Canadian real estate. Other companies, like the Dutch South African and the Dutch Hungarian Bank with similar purposes, were started, but these were not very successful, so that no considerable expansion on these lines is to be anticipated. Like the Dutch, the French, Belgian, and English oversea mortgage banks, they have frequently been made subservient to or have grown out of traffic and other interests, e.g. the Canadian Pacific Railway was partly instrumental in founding the Rotterdam Canadian Mortgage Bank Corporation to provide capital for those occupying land contiguous to the railway line. There are some twenty-seven of these banks. The risk of business abroad being higher, their mortgage bonds must pay higher than those based on home mortgages. Their capital bears a higher proportion to their bonds than the home mortgage banks. They are chiefly interested in granting agricultural credits.

A note might conveniently be added here on ship mortgage banks which have developed in Holland, Belgium, France, and Germany. They lend money on mortgages upon ships. Because of the risk the relation of capital to bonds issued must be relatively high. Loans are granted both on sea-going and river-faring vessels. Ship mortgage banks finance their loans by the issue of bonds against mortgages. The credit they provide and their method of raising the necessary funds for it has, in common with that of the mortgage bank, the features of comparatively long term amortization and the creditor's special rights to enforce his claims. But the security on which loans are based is different in so far as a ship is a mobile asset and not real estate. Since the introduction of industrial mortgage banks which in part also cover their loans by mobile assets, this distinction has become less definite. The same objections which are brought against industrial plants and machinery as bases for the issue of bonds apply more strongly in the case of ships' mortgages, because of the insecurity owing to changes and rapid decreases in value, the absence of a

proper distribution of risks, and to the material difficulty of enforcing claims

Belgium.

As in Holland and France, there are in Belgium a number of overseas mortgage banks granting loans, financed through bonds, exclusively in foreign countries

In Belgium itself mortgage bonds do not play an important part in the financing of real estate credit Rural credits are supplied by the Agricultural Comptoirs and the Co-operative Banks There are banks financing urban property which obtain the necessary funds for their long term loans by the issue of bonds, but many of the mortgage companies and mixed banks dealing in mortgages raise the capital for their loans from short term deposits

Switzerland.

Swiss mortgage banks used to finance their loans in part by the issue of short term debentures falling due at the end of four to six years

Even prior to the War the many objections to this system of financing long term credits by short term money was the subject of much discussion, and various suggestions were put forward for the issue of long time mortgage bonds The disadvantages became more evident during the War and in post-war years owing to the rise in the rate of interest These had to be paid on the renewal of debentures, whilst the rates on long term loans could only be increased with difficulty and with a good deal of friction as they matured Steps were finally taken to provide more adequate facilities for financing mortgage credit, and an Act providing for the issue of mortgage bonds was passed by Parliament in 1930

Because of the objection of the State-owned Cantonal Banks, which were largely engaged in facilitating land credits, against *one* central institute on the ground that they would obtain and grant cheaper credit because of the State guarantee behind

them, *two* central institutes are going to be established for issuing bonds, one for public and another for private bonds

Their organizations follow the Swedish model The central institutes take the form of a private joint-stock company, each with an initial capital of 5,000,000 Swiss francs They may issue mortgage bonds up to an amount equal to twenty times their share capital, and place the funds so obtained at the disposal of their member banks, who, in their turn, cover their debts by first mortgages These may be granted on urban and rural estate generally to the amount of two-thirds of the appraised value Credits will be given to a smaller extent on unimproved real estate and on industrial plants, etc Their business is to be conducted only within the boundaries of the country as is the case in Germany The bonds will run from fifteen to forty years, but may be withdrawn at the option of the issuing bank at the end of ten years upon three months' notice The appointment of a special mortgage bond inspector, and detailed provisions for the publication of balance sheets, show that State supervision is to be strict The decision whether these bonds may be regarded as investments for trust funds is left with the Cantons

The introduction of these new institutes at a time when long and short period rates are both low demonstrates that their primary function is to improve the organization of the banking system Since 1911 the mortgage debt on agriculture has been estimated to remain between three and four thousand million francs

Italy.

Mortgage loans on agricultural and urban real estate are granted by mortgage banks and by savings banks which have special mortgage departments The Monte del Paschi of Siena and the Casa di San Giorgio of Turin, which are well-known savings banks, invest considerably in mortgage loans

The most important of the land credit banks is the Institute Italiano di Credito Fondiario, a joint-stock company with a

capital of Lire 100,000,000 It may make loans on mortgages throughout the country The Mortgage Bank of the Venetian Provinces has issued dollar bonds to the amount of \$5,000,000, which give a yield well over 7 per cent The bank has a capital of \$3,000,000 It grants loans on urban and agricultural real estate up to 30 per cent of the appraised value, and loans to public bodies The bonds in circulation may not exceed fifteen times the capital funds They are additionally guaranteed by the liability of the member banks The present yield on mortgage bonds is about 7½ per cent There are about half a dozen large banks of this type There are also banks with a limited sphere of action which possess at least a capital of Lire 2,000,000, and work in districts where no local credit banks exist Credit associations of landowners owning real estate valued at not less than Lire 5,000,000 are also recognized

The land credit banks grant first mortgage loans on real estate up to one-half of the estimated value, which are repayable by amortization They issue bonds for a face value equivalent to the capital amount loaned The banks undertake to place the bonds given to the borrowers or open a credit on current account in favour of the borrower Although issued at a low rate they are sold at the best price obtainable in the market Loans must not exceed 50 per cent of the appraised value of the property, which yields a sure and continuous income over the whole period of the loan amounting to more than the annuities due to the creditor

The land credit contract in Italy has many of the French features Default on even one instalment closes the transaction and entitles the bank to claim forthwith payment in full When the bank distrains to recover payment it can have recourse to the same summary procedure used by the Government for taxes It may use this method even against the property of provinces and municipalities The bank may also ask the Court for possession If granted, it may administer and pay amortization annuities, and under certain circumstances sell the property and repay itself An unusual form of

guarantee for credits is frequently found A person wishing to build a house can borrow money on the security of the ground floor for the costs of constructing the first floor The ground and first floor are then accepted as a guarantee for the second floor, and so on.

The Ministry of National Economy supervises the land credit banks It sees that they confine themselves to the business authorized by law, that the due ratio between cash mortgage loans and paid-up capital is observed, that the certificates issued correspond to the loans made, etc The banks must transmit the decisions of their boards, which can be vetoed by ministerial decree The Minister can order an inspection to be made at any time

Border and Succession States.

After the period of monetary stabilization the credit situation in these countries has shown broadly the same features scarcity of money and capital, heavy taxes, unfavourable conditions for agriculture both in the home market and abroad, agrarian reform, resulting in the increase of the number of peasant holders, and the demand for agricultural and urban real estate credit, which the home market cannot satisfy The policy pursued is aimed at encouraging the issue of foreign loans

Finland.

There exists in Finland a comprehensive system of old-established mortgage banks, both co-operative associations and private joint-stock companies specially interested in the financing of rural real estate [1] After the stabilization measures were adopted, a series of new mortgage banks was established under Government supervision in order to meet the demand for long term capital

The Industrial Mortgage Bank of Finland was organized

[1] Of the pre-war banks, the bonds of the Nordische Vereinsbank and the Hypotheken Verein, Finland, have been quoted widely on the Continental market

in 1924 It grants loans to industrial companies on first mortgages on their plants, timber land, and hydro-electrical installations up to 50 per cent of the value of the property The mortgages are supervised by and left in trust with the Government bank inspection department While the Industrial Mortgage Bank functions as a private joint-stock company, the Municipal Mortgage Bank, established under special legislation in 1927, works on the co-operative basis The Government contributed a guarantee capital of F M 100,000,000 in the form of 5 per cent Government bonds to the latter It appoints three of the seven directors Loans are granted to their members up to 55 per cent on urban house property, and they are jointly liable up to the amount of the difference of the loan outstanding and the value of the mortgaged property The Government fund can be used only to meet the liabilities of the bank after the members' liability has been exhausted Considering the newness of the country, the Finnish bonds of these two banks have been well received on the U S A and other foreign markets

If the remaining Baltic States have not yet developed as well they are, none the less, all endowed with agricultural wealth The conditions prevailing with respect to mortgage bonds in Finland are also characteristic of conditions in Esthonia, Latvia, and Lithuania

Esthonia.

In order to provide the country with the necessary long term real estate credit a National Mortgage Bank was established by special law in 1928 The capital was fixed at E Cr 200,000,000 Credits are granted on first mortgages up to 40 per cent of the value of agricultural land, and up to 60 per cent for the construction of dwellings or other buildings, providing a regular source of income The loans are granted in the form of mortgage bonds at an average interest of 6 per cent for a period of thirteen to fifty-five years, the yearly amortization payment varying accordingly No issues have been made abroad

The co-operative credit associations (Landschaften) which, previous to the War, provided agriculture with credits (Rmk 5,000,000 of their bonds were issued on the Berlin Stock Exchange by Messrs Mendelssohn), fell into liquidation as a result of post-war political and economic *malaise*

The Agricultural Bank also grants long term mortgage credits The total of loans invested in agriculture is E Cr 85,000,000, of which E Cr 51,000,000 was borrowed from the State The total value of agricultural capital is over Cr 1,000,000,000, of which four-fifths is invested in land, houses, buildings, etc

Latvia.

The mortgage bank system is still in its infancy in Latvia With a view to meeting the demand for long term real estate credit, the Government established in 1922 the State Land Bank for agricultural credit, and in 1924 the State Mortgage Bank was specially designed for urban building requirements Both banks grant long and short term loans, and issue bonds against the property mortgaged, which are guaranteed by the State The long term mortgage indebtedness of the farmers of Latvia amounts to about 190 millions of lats

The State Mortgage Bank grants long term loans from thirteen to forty-one years on the security of mortgages These loans are below three-quarters of the taxable capacity of the estates The rate of interest is between 5 and 8 per cent, but in view of the agricultural crisis has been lessened to 5 per cent Special classes of farmers—those in war areas and those working on Government estates—also obtain loans at reduced rates Long term credits are given in the form of bonds which the bank itself sells, mortgages are registered in a Grundbuch The supply of mortgage credits will remain insufficient as long as the banks do not attract foreign capital

Austria.

The organization of mortgage credit in Austria is very simple as compared with that of Germany Seven provincial

institutions granting long term real estate loans and communal loans are run on non-profit-making lines Credits are granted chiefly to the owners of small- and medium-sized agricultural property as well as to public bodies Besides granting long term credits, these institutions give also short term loans, the funds of which are obtained from savings deposits The long term credits are financed by the issue of mortgage bonds and communal bonds respectively. These bonds guaranteed by the provinces in which the banks operate are trustee investments The public banks, as a result of the conditions governing their issue, have been able to ensure a comparatively good price for their bonds, e g the Upper Austrian Provincial Mortgage Institution issued loans quoted on the Viennese Stock Exchange at the following rate—

1923–1924 at	8%
1926–1927 at	8%
1928– at	7%

In 1928 the total of mortgage and communal bonds issued in the country amounted to Austrian Schillings 216,000,000, of which Schillings 180,000,000 (83 per cent) were issued by these seven banks Farm indebtedness is markedly on the increase, evidence of increased production

The private mortgage banks are mixed banks, having a department for real estate credit which is subject to special State supervision There was, however, after the War, only one bank of this type of real importance—the Oesterreichische Bodenkreditanstal, which granted urban and rural loans secured by first mortgages But this was amalgamated with the Kreditanstalt in 1929 The right of issuing mortgage bonds passes to the new bank

Besides the institutions already mentioned, certain mortgage bond institutes which are attached to savings banks are endowed with the right of issuing bonds, but no such power has been used since 1918 The comparatively small amount of bonds issued in Austria since 1918 may be explained in part by the fact that urban real estate credit has been made practically impossible by the legislation relative to dwellings and

to apartment houses, and in part to the general impoverishment and lack of confidence in the future resulting from the Treaty of Trianon

Czechoslovakia.

There are four mortgage banks in Czechoslovakia granting long term agricultural loans They work under State supervision, and their bonds are guaranteed by the State in which they operate They are the Landesbank of Bohemia, the Moravian Mortgage and Agricultural Bank, the Mortgage Bank of Bohemia, and the Silesian Land and Communal Credit Institutions The scope of their business is very like the German mortgage banks There was in circulation in 1928 a total of Cz Kronen 3,500,000 bonds and debentures issued by these banks, ranging in interest from 3½ to 6 per cent No issues have been made abroad In Slovakia and Ruthenia agricultural mortgage credits are granted by savings banks and co-operative societies which do not issue bonds

Urban mortgage bonds are issued by a number of banks on the home market

Hungary.

Hungary has a well-developed mortgage credit system working on German lines Co-operative associations, joint-stock banks, and savings banks of all kinds are interested in the financing of real estate The Hungarian Land Mortgage Bank, established in 1863, and reorganized in 1924, is a co-operative association operating under Government supervision and endowed with special privileges as to its taxation status The Bank grants long term amortization loans on agricultural real estate up to 50 per cent of the value of the property, and communal loans The bonds issued against the mortgages are secured additionally by the capital of the Bank, Pengo 1,500,000, and by the joint and unlimited liability of the members, the latter including the holders of founders' shares as well as ordinary members They are recognized as trustee investments In 1926 the Bank placed on the market a special

issue of $7\frac{1}{2}$ per cent mortgage bonds in dollars and pounds, intended for sale in New York and London and endowed with special additional securities The total amount of bonds issued may not exceed $25,000,000 as long as bonds of these special series are outstanding

The status of the Farmers' National Mortgage Institute, established in 1879 with a Government subsidy, is practically the same as that of the older institute The State owns about 90 per cent of the share capital of $1,500,000, the business is confined to granting rural mortgage credits A number of 7 per cent dollar bonds to the total value of $5,000,000 were issued in 1928 Seven per cent bonds in the same currency, to the total value of $3,500,000, were issued in 1927 by the Hungarian Mutual Credit Institution This institution, established in 1898 and subsidized by the State, is the central association of the Hungarian Agricultural Associations, all of which must be members The bonds issued against first mortgages on agricultural land up to 30 per cent of the value are additionally secured by the joint liability of the members, who are liable to the extent of five times their participation in the share capital of the association The share capital consists of Pengo 1,000,000, owned by the members, and Pengo 14,000,000, owned by the State

Of the large number of Hungarian mortgage banks specializing in communal loans, most of which are quoted in Amsterdam, the Central Savings Bank alone has placed a small amount of sterling bonds on the London market The Hungarian General Savings Bank, founded in 1881, carries on all kinds of banking business, and instituted a mortgage department in 1903 It has the enviable experience of not having suffered any ultimate loss in connection with any loan, as well as of an unbroken dividend record of forty-eight years At the end of 1929 the Bank's mortgage loans amounted to over £1,500,000 Half of this amount has been raised in the last two years in the form of $7\frac{1}{2}$ per cent Sterling Mortgage Bonds

As in other countries with a great need for foreign capital,

a mortgage bank specially designed for financing industry has been established in Hungary. The National Hungarian Mortgage Institute, founded in 1928 with a capital of Pengo 10,000,000, 80 per cent of which is owned by the Government and 20 per cent by the National Union of Manufacturers, is based on a special law. It issues bonds secured by mortgages of joint-stock companies and co-operative associations carrying on industrial enterprises. Not only land and immovable assets, but also plants, machinery, stock, book debts, and other current assets can be mortgaged. The Bank has placed in the market an issue of 7 per cent dollar bonds to the total value of $5,000,000, for which a special reserve fund is set aside. The bonds, like those issued by the banks doing the more usual mortgage business, are legal investments for trustee funds.

Precisely because of her long experience, Hungary has come to realize the advantage which may be expected from forming a central institute for the issue of mortgage bonds. The co-operation of all the mortgage institutes is being sought for a common scheme for placing bonds.

Poland.

Poland inherited three different systems of mortgage credit organization. The parts belonging previously to Austria, Germany, and Russia developed the same mortgage credit organization as the respective countries to which they were related. The co-operative land credit organizations have been in existence since the latter part of the eighteenth century in Prussian Poland, and they were completed by mortgage banks and savings institutions in Austria and Russia. These systems have continued in operation after the War. But only after 1926 did a revival of activities take place, when domestic capital accumulated slowly and a small amount of agricultural mortgage bonds were placed abroad. In spite of the renewed activities of the Landschaften and the private joint-stock banks after the stabilization, and the credit facilities provided by the State Agricultural Bank, a proper development

of the long term land credit business will depend principally on the possibility of issuing bonds favourably on foreign markets The State Agricultural Bank, established in 1921, and remodelled in 1924, was founded in order to grant loans for the purpose of colonization, development of agriculture, and the administration of certain Government funds The Bank obtains its working capital partly from its share capital, amounting to Zloty 25,000,000, and partly through the endowment of State Treasury deposits of all kinds and the issue of bonds The latter are secured by first mortgages on agricultural land up to 25 per cent of the appraised value, the joint and several liability of the mortgagees and the guarantee of the State The co-operative societies lend to farmers at a rate up to 11 per cent

In the latter part of 1927 the Bank placed on the market a special issue of 7 per cent communal debentures in dollars, which were mainly intended for sale abroad, and a number of 7 per cent mortgage bonds to the total value of £200,000 was offered privately in London during 1928 There are also some 7½ per cent and 8 per cent bonds, expressed in foreign currency It is intended to establish a central mortgage bond bank with the help of international capital

Rumania.

The districts of Rumania which formerly belonged to Austria and Hungary had a highly-developed mortgage credit system working on the same lines as those of the countries to which they belonged During the inflation period after the War these banks broke down, and either went into liquidation or were transformed into ordinary credit banks Local mortgage banks and the farmers' credit banks were formed since the War to meet the credit requirements of large and medium-sized landowners by short term mortgage loans Two land banks, established as co-operative associations in 1923 and 1927 respectively for financing intermediate loans by the issue of bonds on the home market, are unable to meet the requirements for long term credit because of their lack of capital

In 1929 the Rumanian Government decided upon the establishment of an Agricultural Mortgage Bank The capital of £500,000 was to be provided by a group of foreign banks under the leadership of the Banque de Paris et des Pays Bas, the Disconto Gesellschaft, and Messrs Schroeders, London The latter finally withdrew from the transaction The promoters were to facilitate the placing of bonds on the foreign financial markets One serious obstacle to such a loan results from the fact that no unified national mortgage bond legislation applies as yet over the whole country

In 1929 a law was passed introducing the legal instrument of the Grundschuld and the Briefhypothek of the German system. In 1930 the Institute for Provisional Mortgage Credit was created with a capital of Lei 100,000,000 with the object of converting short term loans at high rates into long term loans at low rates It grants credits to the rural mortgage associations for a period of ten to thirty years Long period mortgage bonds are issued only by the Rural Mortgage Credit Company Previous to the war they were quoted at a premium in a number of foreign exchanges To-day they are quoted only at home

Yugoslavia.

The agrarian reforms carried out in Yugoslavia transformed the peasants into landowners This created the necessity for long term agricultural credit, but no comprehensive system of credits existed The legal basis of mortgages varies in the different provinces But it is all to be founded in future on the Austrian law The areas of the country not belonging previously to Austria-Hungary are having a cadastral survey completed The established land banks could not cope with the situation, and this necessitated the payment by farmers of exorbitant rates of interest The only large organizations for long term mortgage loans was the State Mortgage Bank, which extended its activity over the whole of Yugoslavia in 1922 The State Mortgage Bank was established as early as 1862, and became in 1898 a central mortgage bank, working under

Government supervision, but in fact its scope was restricted This bank grants loans on agricultural and urban real estate, secured by first mortgages up to 50 per cent of the appraised value, in practice these loans do not exceed 33 per cent They are made to the Government or to other political bodies, and are secured either by mortgages or by the pledge of revenues or taxes The Bank issues mortgage bonds against its mortgage loans, and communal bonds against the credits granted to public bodies They are guaranteed by the State and are trustee investments In 1928 the capital of the bank amounted to Dinars 70,000,000, the public funds deposited with the Bank to Dinars 600,000,000, the ordinary deposits and trustee funds to more than Dinars 600,000,000 The total of bonds issued on the foreign market amounted to Dinars 900,000,000, the total of mortgages granted to Dinars 1,900,000,000 Most of the credit granted was on urban property, less than one-tenth of the loans were devoted to farm credit

In order to meet the need for agricultural long term credits, the Yugoslavian Government, in April, 1929, passed a law with the object of establishing a privileged Agrarian Bank This is a joint-stock company, with a capital of Dinars 700,000,000, subscribed chiefly by the State, other public bodies, and the leading banks of Yugoslavia, working under the supervision of the State, which takes a leading part in its administration The bank is empowered to grant long and short term credits and to discount bills The bank is given the right to issue mortgage bonds guaranteed by the State, and these bonds and the shares of the bank are exempt from taxes Furthermore, there is a State guarantee for savings deposits entrusted to the bank, and a guaranteed dividend of 6 per cent on its shares

Within a year the new agricultural bank had helped to reduce considerably the cost of money to the peasants, and lent them some Dinars 800,000,000 Over 65 per cent of the peasant farmers have incurred long term liabilities These amount to some Dinars 3,800,000,000, which is estimated to be about one-tenth of the value of the soil

Bulgaria.

The organization of mortgage credits in Bulgaria was centralized until recently in the two principal State banks They were endowed with the exclusive right of issuing bonds Urban real estate credits were granted by the mortgage department of the National Bank of Bulgaria, established in 1879, and agricultural credits by the Bulgarian Bank of Agriculture, a State institution established in 1894 In 1927 the mortgage department of the National Bank had to be closed down in accordance with the request of the Council of the League of Nations The loans granted by the Bank of Agriculture, by private mortgage banks, and by the insurance companies were quite insufficient to meet the long term credit requirements

The Bulgarian Government decided to appeal for foreign capital,[1] and in 1928 a new mortgage bank was established in Sofia on the basis of a special law with a share capital of 10,000,000 Swiss francs The Bulgarian Mortgage Bank is organized as a limited liability company, working under State supervision Most of the shares are in the hands of the State and of Bulgarian municipalities The bank issues bonds for an amount equal to the mortgages granted These are Government guaranteed, amortized, and repayable by the drawing of lots

The distribution of small agricultural credits will remain the function of the Bank of Agriculture which acts as an agent for the new Bank The rate of interest to the borrower must not exceed the rate of interest paid by the bank to the holders of its bonds by more than 2½ per cent, and is thus likely for the time to be at least 10 per cent The promoters promised to grant loans which were to be repaid by the issue of bonds They also assured the placing of these on the foreign capital markets Up to the end of 1928 the Bank granted loans amounting to 9,000,000 Swiss francs In the Spring of 1929 the Bank had to stop temporarily its operations because its funds were exhausted, and no foreign loans could be raised

[1] Through Messrs Blair & Co, The Foreign Corporation, New York, Lazard Bros, London, and the Amsterdamsche Bank

owing to the unfavourable situation on the international bond market, and, in any case, the Bulgarian consolidated loan was to have precedence

The Bulgarian Bank of Agriculture regards it as its duty to aid Bulgarian agriculture, which is being rationalized But the rates are high Mortgage loans are issued at 12 per cent per annum up to 80 per cent of the value of the property

Co-operative banks borrow short term loans at 10 per cent, but they charge peasant proprietors some 12 to 13 per cent When farmers borrow from private banks they pay ordinarily some 15 to 16 per cent, but when they borrow from private lenders they pay 16 to 20 per cent

A clearer picture of the agricultural credit situation in the Central and East European States is obtained by comparing their total indebtedness, the debt per hectare of cultivated land and the usual rate of interest

	Total Agricultural Indebtedness	Debt per Hectare of Cultivated Land	Rate of Interest[1]
Bulgaria	$61,000,000	$10 97	Up to 10%
Esthonia	$23,000,000	$8 12	Up to 7%
Hungary	$245,000,000	$33 74	Up to 8%
Latvia	$49,000,000	$14 79	Up to 8%
Poland	$251,000,000	$10 24	11%
Rumania	$240,000,000	$14 02	12–15%
Yugoslavia	$733,000,000	$59 0	12–15%

Total for these countries, $1,582,000,000

[1] Usurious charges are common In Poland and Bulgaria they are 20% or even more In Rumania they are 30%, and in Yugoslavia might reach even 50%

Greece.

The necessity of approaching foreign markets in order to obtain long term real estate credits led to the establishment

of the National Mortgage Bank of Greece in 1927 The Bank is a State bank working under close Government supervision The initial capital of Drachma 80,000,000 was subscribed by the issuing bank of the country It grants long term amortization loans to urban and rural real estate owners and to public bodies These loans are financed by the issue of mortgage bonds which have the additional guarantee of the National Bank of Greece, the maximum issue being restricted to twenty-five times the paid-up capital

A sterling loan to the amount of £3,000,000 was issued on the London market in 1927

Spain.

Spain has a monopolistic mortgage bank and an independent bank for communal loans

The Mortgage Bank of Spain has granted loans on the basis of first mortgages on farm and town property, and has issued Cédulas since 1873 The Law of 1876 gave it the exclusive power No more than half the value of the security is lent

The capital of the Bank and its reserves now exceed 70 million pesetas, and the Cédulas in circulation amount to over 1,100 millions. They have been issued to carry different yields, some on a 4 per cent, some on a 5 per cent, and some on a 6 per cent basis They enjoy a ready market on the Spanish Stock Exchanges

The Spanish Bank for local loans was established by Royal Decree in May, 1925 It acts as a Government institution with the exclusive object of granting credits on the security of properties and revenues No more than 25 per cent of these incomes may be pledged Loans are granted on works of great need which are likely to be productive very soon In the first years of its operation loans of over 500 million pesetas have been raised The bank issues 500 peseta Cédulas generally at a slight discount The first series were on a 5 per cent basis, a later series on a 5½ per cent basis, and the latest is on a 6 per cent basis Since the security is the same the market price of the earlier issues has correspondingly declined

Russia.

Mortgage banking in Russia followed on familiar lines until the October Revolution There were ten joint-stock land banks which granted long term loans against the mortgage of land and against town real estate for periods ranging from ten to sixty-six years The borrowers were given their own mortgage bonds, which bore interest at 4½ per cent About two-thirds of the total of bonds, which in 1914 was about 1,300 million roubles, related to agricultural land This type of bank, whose credit cost the borrowers more than 5 to 6 per cent, was of little use to the big landowners with their inefficient methods of farming and their extravagant habits The State Nobles' Land Bank was founded in 1885 to grant loans upon mortgaged land only to hereditary nobles They received privileges from the outset Soon they obtained their loans in cash instead of in bonds, and this resulted in their paying less for credit than borrowers from the joint-stock banks They were allowed to prolong their loans, to defer payments, and even have their arrears written off Moreover, seven out of ten borrowers from the Nobles' Bank who received 60 per cent of the value of their property on first mortgage, applied for loans under second and third mortgages elsewhere It became evident that these loans were not employed for land improvement A fast increasing amount of their territory was being sold to persons of non-noble origin The Peasants' Land Bank was established in 1883 to facilitate the purchase of land by peasants from the big proprietors In 1907 the Bank began to grant loans against the mortgages of peasants' allotments Broadly, previous to the War, this form of credit was developing steadily, though, in view of the size of the country, on a very limited scale

With the October Revolution these institutions were liquidated, and the Soviet Government introduced a new organization to serve agriculture and industry

The Central Agricultural Bank gives credit to Government and to peasant farmers The great Government estates which are to be "bread factories" are to substitute the individual

farms now operating Experiments are being made to work these on a scale which enables them to introduce all the economies of large scale operation It is claimed that three-quarters of a million peasants working on such estates would suffice in a comparatively short time to feed all the city workers and the army

The Prombank is the State Bank which caters for the long term credit needs of industry The Budget grants allotted for new industrial buildings go to this bank It, in turn, grants loans in the form of long term credits to different State organizations which need credit for new buildings and for the enlargement of their existing plants Thus we see that instead of having to go to the market to borrow, the banks obtain their capital out of the Government budget

South American Republics.

Mortgage banks have enjoyed a considerable development in the South American Republics In most of them a central governmental bank, as in the Argentine, or a subsidized bank is the most important institute even where, as in the case of Colombia, other banks are working side by side and in competition with it In Brazil, where a central institute is still lacking, it is projected The bonds of some of the South American Republics are well established in the international markets

Brazil.

The Brazilian land credit laws allow any persons who comply with it to form a company, so that the competitive system has sprung up in this country In spite of the existence of a certain number of banks dealing in agricultural and city real estate credit, the problem of an adequate provision of mortgage credits is not yet solved

In some States the big landowners are comparatively well provided for by mortgage banks founded with French capital, working under Government supervision, and in some cases with Government guarantee The bonds issued are placed

chiefly on the French market The most important of these banks are the Banco Hipotecario et Agricola de Minas Geraes, established in 1911 with a capital of Frs 10,000,000, the Crédit Foncier du Brézil et de l'Amérique du Sud, established in 1906 with a capital of Frs 50,000,000, 69 per cent of which is held by the State

In 1923, the establishment of a large-scale National Mortgage Bank, working throughout the whole country, was decided upon This Mortgage and Agricultural Credit Bank was to have had the form of a limited liability company, with an initial capital of Milreis 20,000,000, to be increased later to Milreis 50,000,000, the half of it subscribed by the Union Bonds were to be issued against first mortgages up to ten times the capital at an interest rate of 6 per cent, guaranteed by the Union But this project has not yet been realized

Chile.

The Chilean Land Credit Law of 1855, like that of Brazil, allows any persons who comply with its terms to form a company A number of mortgage banks issuing bonds are doing good business, but they operate under disadvantages compared with the Credito Hipotecario, which is granted privileges under the general law and which does two-thirds of the mortgage business of the country These private banks cannot compete with it successfully

The Caja de Credita Hipotecario is a Government institution It has no share capital, its profits are limited to an amount necessary to cover the administrative expenses and to maintain a reserve fund as additional security Loans are granted on agricultural and urban real estate on first mortgages up to 50 per cent of the value in Cédulas, which the borrower sells in the open market The borrower redeems his loan either by re-purchasing the Cédulas, or by payment in cash In the latter case the Bank deposits this cash in its special amortization fund, and in due time the requisite number of bonds are drawn by lot for repayment at par

All the bonds issued are guaranteed by the Government

and are free of fiscal charges In 1928, the total value of bonds outstanding was $143,000,000, of which £400,000 and Frs 28,000,000 were external issues

The Treasury and the National Savings Banks invest in these bonds, they are listed on the Stock Exchange of many European countries Their security is considered as being practically the same as that of the Chilean Government, the only South American Republic that has never really defaulted During its seventy-five years of existence the Caja has never failed to meet its obligations The losses on property foreclosed during the last fifteen years is less than 1 0 per cent

Colombia.

The law relating to the institution of the State Agricultural Mortgage Bank in 1923 regulates also the establishment and the working of the commercial mortgage banks and the mortgage sections of the credit banks

The pure mortgage banks deal mainly with the issue of bonds and the granting of long term loans amortizable by annual payments Their business activities are supervised by a State Comptroller The law grants special privileges to these banks including exemption from stamp duties The mortgage constitutes a loan on the entire property until the loan is fully paid

The Board of the Agricultural Mortgage Bank, which is organized as a State Bank, is appointed by the central government, the local governments, and the departments respectively They own the capital amounting to Pesos 5,000,000 The Bank conducts its business as a general mortgage and credit bank Mortgage loans are granted up to 50 per cent of the value of agricultural property The amount of bonds issued may not exceed five times the capital They are guaranteed by the State and are free of charges The interest on loans must not exceed 10 per cent In 1928, property mortgaged to the bank was valued at £135,000,000, the loans totalling £4,000,000, against which there had been issued bonds equivalent to £3,500,000 This represents a very wide margin of

safety These bonds are regarded as providing a sound high yielding investment In 1929 about 46 per cent of the loans were granted to city property, about 27 per cent to agricultural estates, and 27 per cent to the Government authorities The loans aggregate less than 25 per cent of the appraised value of the properties mortgaged Until 1927 the total losses incurred were 03 per cent

The only Colombian private joint-stock company which issues its bonds on the international market is the Mortgage Bank of Bogota, established in 1910 with a share capital of Pesos 4,000,000 It grants mortgage loans on agricultural and city real estate up to the amount of 50 per cent of the appraised value, and loans to municipalities secured by revenues The Bank declares that it has never sustained a loss on any of its loans

It is the practice of the Caja to make its loans against which bonds payable in foreign currency are issued also payable in that currency by the borrower, except in cases where it has obtained the guarantee of the Republic of Chile for any loss resulting from exchange fluctuations

Cuba.

In 1911 the Territorial Bank of Cuba, a private joint-stock company with a capital of $5,000,000, was given an exclusive monopoly for sixty years to issue bonds on the basis of short and long term credits, secured by mortgages These are always amortization loans, the maximum interest allowed on them is fixed at 7 per cent

Uruguay.

The Banco Hipotecario del Uruguay, formerly a private joint-stock company, was converted into a public institution in 1911 It is a pure mortgage bank granting real estate loans up to 60 per cent of the value of the land The bonds guaranteed by the Government have an active market in certain European countries

Costa Rica.

In 1912, Costa Rica founded a State Land Mortgage Bank similar to that of Chile In order to induce investors to buy the bonds of this bank, they are exempted from the 2 per cent tax on deposits and securities, and constitute an investment for trust funds

Mexico.

Mexico has a regulated competitive system of mortgage banks working under Government supervision In accordance with the law of 1908, the joint-stock banks may grant short and long term loans secured by urban or rural property up to 50 per cent of the appraised value The total amount of bonds issued must not exceed twenty times the paid-in capital In the event of default by the borrower the banks may resort to summary procedure for foreclosure and sale The internal disturbances which have seriously interfered with all banking business in Mexico have also affected the mortgage banks

The Caja de Prestanos, established in 1908 with a capital of Mex $10,000,000, which issues bonds guaranteed by the Government, has not paid interest on them since 1914, the Banco Internationale Hipotecario stopped payment in 1917 The third of the mortgage banks whose bonds are quoted on the international Stock Exchanges, the Crédit Foncier Mexicain, also has defaulted

British Dominions.

The Dominions, Dependencies, and Protectorates associated within the British Empire have adopted different policies concerning this type of bank Some, such as Cyprus and Palestine, have specially organized mortgage banks, others, such as New Zealand, the Union of South Africa, and Australia, have added rural credit departments to their central issuing banks or savings banks, and these obtain their working capital in part through the issue of debentures In India, in spite of the great need for rural credit, there has hitherto been a disinclination to deal with the practical difficulties involved in mobilizing

it most efficiently Ireland has instituted an Agricultural Credit Corporation which issues bonds One of the most useful fruits of the movement for Empire economic unity might be the establishment of an Empire Mortgage Bank

Canada.

Canada is a new country, and her first need is the development of her agriculture, minerals, and manufacture The whole of her banking system is adapted to this main task She turns to New York, the financial centre of the whole North American continent, for aid But she has herself become an exporter of capital The present land mortgage problem exists in a large measure in connection with the improved farms which were purchased during the period of inflated land values in the war and post-war period Payment for interest and amortization must be made now when the prices of farm products have fallen considerably Long term agricultural credits are essential, especially in the West, and these cannot be given by the commercial banks Until now provincial mortgage banks and loan and insurance companies have granted credits to farmers, but their conditions as to rate of interest and period of repayment are unsatisfactory Of these three classes of lending companies, by far the largest portion of the farm mortgage business is in the hands of the mortgage companies proper The credit operations of the various loaning companies are carried on mainly in the newer parts of the country, and a great portion of their business is connected with urban property Loans are usually granted for five years on first mortgages at an average rate of 8 per cent Repeated suggestions have been made that a Governmental system of mortgage banks should be instituted, preferably on lines similar to those of the United States Federal Farm Loan Organization Two Bills were presented to achieve that in 1925 and 1927, but neither was adopted

Australia.

Rural estate credits in Australia are financed by agricultural and credit mortgage banks, and co-operative credit societies

There is also a special Rural Credit Department of the Commonwealth Bank They obtain their capital from issues of debentures, savings bank deposits, and from Government funds, and aim at enabling farmers to settle on the land But, in fact, some of the advances are used by farmers established for many years who require long term capital Additional provisions are made in all States for loans to settlers The Victorian Closer Settlement Board makes advances to Crown lessees, to workmen for the erection of dwellings, to soldiers, and to settlers affected through drought The facilities for pioneer settlement have been on a large scale Over 90 million pounds have been advanced in all, of which over sixty are outstanding But in spite of these services, the local storekeeper, the private company and merchant still provide most of the rural credits The insurance companies, trustee, executor, and agency companies, and building and investment societies use some 90 per cent of their funds in advances on mortgages They thus stimulate building operations The aim of the law is to make it as easy to transform real estate into mobile credit and to transfer real estate from one person to another, as to transfer bills of exchange or Stock Exchange securities The Torrens system, as it is known, establishes absolute ownership through a legal instrument which cannot be contested, provides for the constitution of the mortgage and the liquidation of a credit with the greatest ease and speed and the least expense, and makes provision for a system of the completest publicity, which enables the charges on every piece of property to be known

The loans which the European mortgage banks grant to communal bodies are provided in Australia by the ordinary banks These advance long period loans to municipal and local public bodies by taking as security "the service of some special rates upon which debentures have been issued"

New Zealand.

The Bank of New Zealand decided in 1926 to set up a special department for agricultural long term amortization

credits Until then no adequate provision for long term credits existed, the great bulk of mortgages were given for three to five years, with no proper provision for the reduction of the principle, whilst the repeated renewal of the mortgages involved heavy charges

The Bank of New Zealand raised £1,500,000 long term mortgage capital for this purpose One-third was subscribed by the Government, and two-thirds by the public Amortization loans are now granted for 36½ years on first mortgages, are financed by mortgage bonds issued up to an amount of three times the paid-up capital, and they are free of taxation

India.

One of the greatest difficulties confronting Indian agriculture is the lack of financial accommodation for fairly long periods In 1863 the Land Mortgage Bank of India was started, based on the same principles as the Crédit Foncier de France Business proved so successful at first that similar institutions for other parts of the Empire were started by London financiers, for example, the Australian Mortgage and Finance Company, the Mauritius and Land Credit Company, etc The Indian Bank, however, broke down in 1883, because of over-investment in city real estate, without the necessary safeguards being taken

For many decades the agriculturalists have been dependent on native moneylenders who charge exorbitant rates In Bengal there are Government loan offices which grant short term loans at comparatively high rates It is not surprising, therefore, that throughout India to-day there is a demand for a new credit system But there are two main schools, one advocating the French system of financing agriculture through Government funds and offices, and the other putting forward a scheme of finance through the issue of mortgage bank bonds Political conditions alone can explain the dilatoriness of the authorities in dealing with the Linlithgow Commission Report of 1926 There is also an urgent need for credit for urban real estate, and the French system of mortgage has been

recommended also for this purpose. The co-operative land mortgage bank business is making headway. There are twelve banks in the Punjab and fifteen in Madras.

South Africa.

The Land and Agricultural Bank of South Africa provides long term real estate amortization loans partly by the issue of Government guaranteed debentures. When established in 1912, this centralized institution took over the capital of nearly three million pounds of the former provincial agricultural banks. Parliament has since voted an additional £5,500,000, for which it is paid 4.5 per cent, the rate paid by the Treasury. These debentures, which are secured by all the assets of the bank, are not mortgage bonds of the Continental type—they come rather into the same category of security as the debentures of the Agricultural Mortgage Corporation of England. Owing to the operations of the Land Bank, the insurance companies find a free field to grant loans on town properties.

In South Africa, Government Departments give aid directly to schemes for the development of the country. The Land Department advances large sums primarily to settlers for the purchase of land on very reasonable terms, and the Irrigation Department provides facilities for large irrigation schemes.

Egypt.

Egypt has a well-developed mortgage bank system. About five-sixths of the total of mortgages granted are held by the five mortgage credit banks now existing in the country.

The leading institutes organized as private joint-stock companies without special privileges are the Egyptian Land Credit Company, established in 1880 with a share capital of Frs. 200,000,000, granting mortgage loans on real estate up to 50 per cent of the value to large and middle-sized landowners, and the Land Bank of Egypt, established in 1905 with a capital of £1,000,000, and the Mortgage Company of Egypt, founded in 1908 with a capital of £2,000,000. The bonds

of these two latter banks are quoted on the London Stock Exchange, while the Egyptian Land Credit Company frequently has placed issues with the Paris Stock Exchange

The Agricultural Bank of Egypt, established in 1902 to attend exclusively to the needs of small landowners, is a private joint-stock company and is supported and controlled by the State One-third of the capital of £4,000,000 is owned by the National Bank of Egypt The bonds, secured by first mortgages on real estate up to 50 per cent of the appraised value, are guaranteed by the Government

Japan.

Japan has a number of mortgage banks engaged in the financing of long term real estate loans The most important is the Hypothek Bank of Japan, a private joint-stock company, and the Industrial Bank of Japan The Hypothek Bank has a share capital of 99,000,000 yens, and is authorized to issue mortgage bonds up to fifteen times the paid-up capital It may use its funds for real estate amortization loans on agricultural and urban property within a period not exceeding fifteen years, the amount to be loaned on residential property being restricted to 50 per cent of the total credits granted, it is allowed to make unsecured loans to public bodies, and it may underwrite the issue of bonds of local banks furnishing long term real estate loans at low rates

The Industrial Bank has a capital of 50,000,000 yens It makes first mortgage loans on lots and buildings, factories or residences in certain areas, and on trustee property It also grants credits on the pledge of national and local loan bonds and corporation bonds and shares Local agricultural and industrial banks may issue bonds against loans to an extent exceeding ten times their capital They are joint-stock companies which do, on a small scale, what the Hypothek and Industrial Banks do for the country as a whole

At present agricultural loans are given to farmers at an average rate of 7 per cent, whilst credits secured by buildings

or residential property cost about 8 per cent Mortgage banks pay for loans about 1 per cent below these amounts The indebtedness of farms, arable land, houses, and building is steadily mounting It had more than trebled during the period 1914 to 1925, when it reached over 5,000,000,000 yen.

APPENDIX I

TABLES OF MORTGAGE BOND ISSUES

Notes on Tables

In the following tables the reader will find the figures and data of representative bond issues of a number of the leading mortgage banks They are confined to a skeleton account of the bond issues quoted on the central stock markets, and to certain bonds issued on the home market only

The selection of the bonds has been directed by two considerations An attempt has been made to illustrate the extent of borrowing, especially on foreign markets, and to give a survey of certain characteristic features in the growth of mortgage banks Therefore, besides tabulating the largest loans, smaller ones were included only so far as they bore upon this development

It was difficult to obtain sufficient analogous information for all the banks to make possible an adequate comparison of their bonds, and in some cases the collection of the necessary data was, indeed, impossible The tables are therefore not equally complete

Each table includes the amount of bonds issued and the amount of bonds outstanding for the year ending 1930, security, sinking fund, price, and a note describing the status of the issuing bank The name of the Stock Exchange on which the bond is issued is given only where the denomination of the loan itself is not a sufficient indication If there is no note to the contrary, the payments on loans between one country and another are made at current rate of sight exchange Under the heading "Security," the percentage figure given is the legal limit up to which loans may be granted Wherever possible the highest and the lowest prices for the year are given

The sources of information on which these tables have been based are, besides the annual reports of the banks wherever

obtainable Moody, *Banking and Finance* and *Government Securities* (New York), Kimber, *Government Loans* (New York), *Standard Statistics* (New York), for Dollar bonds, the *London Stock Exchange Year Book* and *Stock Exchange Investment List* (London) for Sterling bonds, *Annuaire Desfossées* (Paris), *La Cote Alphabétique de toutes les valeurs cotées* (Paris), for issues quoted in France, *Schweizer Valoren* (Zurich), *Tages-Kursblatt der Wichtigsten Valoren der Börse von Zurich, Basel, Genf, Lausanne,* for issues quoted in Switzerland, and *Gids bij de Prijscourant van de Vereeniging voor den Effektenhandel* (Amsterdam), for issues quoted in Holland The tables are arranged according to countries

ARGENTINA

	Security	Sinking Fund	Price 1926	1927	1928	1929	1930	Note
Argentine Banco Hipotecario Nacional[1] Total amount of Cédulas outstanding, June 30, 1930 5% Series K of 1905 6% Series L 6% 1–35 $1,400,000,000	*First mortgages* on urban and rural real estate (50%) except on loans over 200,000 pesos, loans to corporations and to amusement places, in which cases the mortgage must not exceed 40%, 30% and 20% respectively Government guarantee	Each series redeemable by a cumulative sinking fund of 1 per cent per annum at par by purchase or lot						State Bank *Established*, 1886 *Capital*, $180,000,000 Consisting of various Reserve Funds *Bonds issue* equal to mortgages granted *Scope of business* Mortgage credits on urban and rural real estate
I 6% Pesos 500,000,000, 1912–1944 Out, Pesos 350,000,000 Paris			H 700 L 460	H 523 L 464	H 504 L 492	H 486[2] L 482	H 463 L 420	
II 6% Pesos 500,000,000, 1900–13–1946 Out, Pesos 147,000,000 Genf			H 98 L 91 25	H 103 L 98	H 103 50 L 100 25	H 101 15 L 95	H 94 L 23	
London			H 44¾ L 38⅝	H 46 L 42½	H 46½ L 42⅛	H 45½ L 41½	H 42 L 33¾	

[1] For detailed reference see Chapter VI

BRAZIL

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Bank of the State of San Paulo I 6½% £1,250,000, 1927–1947, issued at 92 Out £1,220,000	First mortgages on agricultural and urban real estate Government guarantee	Semi-annual cumulative, by lot at par		92[1]	93½[1]	74½[1]		Private Joint Stock Co *Established* 1909 *Capital* £1,250,000 69% held by State *Reserves* £200,000 *Scope of business* Mortgage loans on urban and agricultural real estate
II 6% £1,250 000, 1928–1948, issued at 94 Out £1,190,000		Semi-annual cumulative, by lot at par			92½[1]	72½[1]		
III 6% £1,250,000, 1928–1948, issued at 94½ Out £1,210,000		Semi-annual, cumulative, by lot at par				72½[1]		
Crédit Foncier du Brésil et de l'Amérique du Sud I 5% Series A Frs 37,500,000, 1910–1965 II 5% Series B Frs 32,500,000, 1913–1965	First mortgages, (50%) on real estate	Annual, cumulative, by purchase or drawing at par	H 510 L 326	H 542 L 315	H 530 L 428	H 465 L 390	H 470 L 424	Private Joint Stock Co *Established* 1906 *Capital* Frs 550,000,000 6% held by Government *Reserves* Frs 18,000,000 *Bonds issue*, Ten times paid up capital *Scope of business*, Mortgage loans on real estate
Banco hipotecario et agricola de Minas Geraes I 5% Frs 20,000,000 1911–1961	First mortgages on agricultural property (50%)	Annual, by lot or purchase at par	H 1,635 L 6,05	H 1,060 L 5,75	H 1,295 L 850	H 1,325 L 951	H 1,960 L 1,912	Private Joint Stock Co *Established* 1911 *Capital* Frs 10,0000,000 *Reserves* Frs 2,500,000 *Bonds issue*, Ten times paid up capital *Scope of business*, Mortgage loans on agricultural real estate

[1] Price quoted on December 15th

CHILE

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Mortgage Bank of Chile I 6½% $20,000,000, 1925–1957, issued at 97⅝ Out $19,100,000	First Mortgages (90%) on agricultural and urban real estate, Legal investment for trust funds Government guarantee	Semi-annual, cumulative, beginning Dec 31, 1925, callable by lot at par	H 98¼ L 94¾	H 97½ L 93	H 99¾ L 95¾	H 99¾ L 83⅛	H 99 L 76	State Bank *Established* 1855 *Capital* No share capital, only reserve fund, contributed by Government, is not operated for profit *Bonds issue* Equal to mortgages granted *Scope of business* Mortgage loans on urban and agricultural real estate, unsecured loans to a large irrigation company, created by special law in 1908 On Dec 31, 1929, Total of bonds outstanding, $175,800,000
II 6¾% $20,000,000, 1926–1961, issued at 99½ Out $17,500,000		As above, beginning Dec 31, 1926	H 99⅛ L 96⅞	H 98¼ L 96	H 101 L 96¾	H 100⅝ L 90⅛	H 100¾ L 84½	
		No sinking fund		H 97½ L 94¾	H 99½ L 93	H 98⅛ L 94½	H 101 L 96	
III 6% $20,000,000, 1928–1961, issued at 95½ Out $19,700,000		Semi annual, cumulative, callable by lot at par			H 95 L 91	H 94 L 82⅝	H 94 L 69	
V 6% $20,000,000, 1929–1962, Coupons $500, $1,000 Trustees as above		As above					H 91 L 62½	
VI 5% Frs 58,825,000, 1912–1950, issued at 96½ Out Frs 19,000,000 Geneva		As above		H 89 50 L 84	H 91 50 L 86	H 94 L 86	H 96 L 90	

COLOMBIA

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Agricultural Mortgage Bank of Colombia I 7% $6,000,000, 1926–1946, issued at 94 Out $5,400,000	First mortgages on agricultural real estate (50%) Government guarantee	Semi annual cumulative by purchase or lot at par		H 99½ L 95¼	H 98 L 90	H 93 L 70	H 78 L 71	State Bank *Established* 1925 *Capital* Pesos 5,000,000 88% owned by Government and public bodies *Reserves* Pesos 2,000,000 *Bonds issue* Five times capital plus reserves Each issue has a separate sinking fund *Scope of business* Mortgage credits on agricultural real estate
II 7% $3,000,000, 1927–1947, issued at 95½ Out $2,800,000		Semi-annual cumulative by purchase or lot at par		H 99⅜ L 96⅜	H 98 L 88¼	H 95¼ L 78	H 78 L 70	
III 6% $5,000,000, 1927–1947, issued at 92 Out $4,000,000		Semi-annual, cumulative, by lot or purchase at par		H 99½ L 89	H 88½ L 54	H 93½ L 83½	H 72 L 65½	
IV 6% $5,000,000, 1978–1948, issued at 93½ Out $4,500,000		Semi-annual cumulative, by lot or purchase at			H 91¼ L 88⅛	H 90 L 63	H 80½ L 55	
V 6½% £1,200,000, 1929–1959, issued at 95 Out £1,200,000		Semi-annual cumulative, by lot or purchase at par				H 93¼ L 79	H 90½ L 77½	Private, Joint Stock Bank *Established* 1910 *Capital* $3,900,000 *Reserves* $1,000,000 *Bonds issue* Ten times capital plus reserves *Scope of business* Mortgage loans on urban and agricultural real estate, loans to municipalities secured by mortgages or reserves Total of Bonds outstanding, 1929, $26,000,000
Mortgage Bank of Bogota I 7% $3,000,000, 1927–1947, issued at 97½ Out $2,800,000	First mortgages on urban and rural real estate (50%) and special revenues pledged by municipalities	Semi-annual cumulative, by purchase at par			H 97 L 90	H 94 L 81⅞	H 82¾ L 71	
II 7% $3,000,000, 1927–1947, issued at 97½ Out $2,900,000		Semi-annual cumulative, by purchase at par			H 95⅛ L 91	H 94 L 85	H 82¼ L 65½	
III 7% £1,660,000, 1928–1958, issued at 92½ and 96½ Out 1,400,000		Semi-annual cumulative, by lot or purchase at par			H 103¾ L 93⅜	H 100½ L 88	H 96¾ L 74½	

CYPRUS

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Agricultural Bank of Cyprus I 5% £200,000, 1929–1980, issued at 95%	First mortgages, (50%) The *Ottoman Bank* guarantees the Sinking Fund payments The Governor of Cyprus guarantees the payment of interest	Annual, cumulative, ½% per annum by purchases or obtaining at par beginning Dec 31, 1930				H 96⅜ L 94		Private Joint Stock Co *Established* 1925 *Capital* £50,000 held by Ottoman Bank *Bonds issue* Equal to mortgages granted *Scope of business* Mortgage loans, chiefly to agricultural co operative societies

DENMARK

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Mortgage Bank of the Kingdom of Denmark I 5% $5,300,000, Series IX, 1927–1972, issued at 92 Out $5,300,000	First mortgages or mortgage bonds issued on first mortgages by small farmers' associations, or municipalities for building loans, guaranteed by the Government, further bonds issued by the Danish Credit Unions, i e local credit unions issuing bonds (60%) against first mortgages and municipalities, who are jointly and severally liable for their obligations Government guarantee Legal investment for trust funds	Semi-annual, from 1933 in redemption of yearly $66 500 at par, plus accrued interest, by purchase or lot		H 96¾ L 96	H 100⅞ L 95	H 97 L 93½	H 100¼ L 95¾	State Bank *Established* 1906 *Capital*, $25,360,000 Owned by Government *Reserves* $2,370,000 *Bonds issue* Eight times capital
II 4% Kr 19,999,000, Series III, 1912–1973 Out Kr 10,000,000 (Paris)		Semi-annual cumulative, by purchase or lot at par	H 2835 L 1800	H 1965 L 1790	H 2055 L 1900	H 2,040 L 1,945	H 2,175 L 1,985	*Scope of business* Central agency for financing certain types of urban and rural mortgage credits, and municipal loans as described under Security

EGYPT

	Security	Sinking Fund	Price 1926	1927	1928	1929	1930	Note
Agricultural Bank of Egypt I 3½% £2,500,000, 1904–1949 Out £1,485,000	First mortgages on agricultural real estate (50%) Government guarantee		H 76 L 71½	H 76½ L 72⅝	H 82½ L 78	H 84½ L 82	H 86 L 83½	Private Joint Stock Co *Established* 1902 *Capital* £4,000,000 *Bonds issue* Equal to mortgages granted *Scope of business* Mortgage loans to small farmers
II 3½% £4,200,000, 1906, 1907, 1908–1949 Out £2,682,000	First mortgages as above, guaranteed by Government, by endorsement		H 77 L 75	H 78¼ L 75¾	H 83 L 78	H 85½ L 81	H 86⅜ L 83½	
Mortgage Company of Egypt I 4½% £1,000,000, 1910–1950 £750,000, 1912–1950	First mortgages on agricultural real estate (50%)		H 82 L 76½	H 82⅞ L 80⅝	H 83¾ L 79½	H 83 L 81	H 84½ L 80	Private Joint Stock Co *Established* 1908 Since 1922 under the control of Agricultural Bank of Egypt *Capital* £2,000,000 Paid up, £1,250,000 *Bonds issue* Equal to mortgages granted *Scope of business* Mortgage loans on rural real estate
Crédit Foncier Egyptien 3% Frs 100,000, 1903–1953 Issued at 92 Out Frs 75,000,000 Geneva	First mortgages on real estate (60%)	Semi-annual, by lot at par	H 440 L 330	H 415 L 375	H 424 L 370	H 380 L 279	H 330 L 280	Private Joint Stock Co *Established* 1880 *Capital* £ , , *Bonds issue* Equal to mortgages granted *Scope of business* Mortgage loans on real estate

FINLAND

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Industrial Mortgage Bank of Finland I 7% $12,000,000, 1924–1944, issued at 95 Out $9,000,000	First mortgages on plants, timberland and hydroelectric installations (50%) Government guarantee	Semi annual $60,000 each year to retire through drawing or purchase, beginning Jan 1, 1925, to and including Jan 1, 1933, at 101 plus interest, to and including Jan 1, 1939, at $100\frac{1}{2}$ plus interest, to and including July 1, 1944, at par plus interest	H 101 L $98\frac{3}{4}$	H 102 L $99\frac{7}{8}$	H $102\frac{1}{2}$ L $99\frac{1}{4}$	H 102 L $97\frac{3}{4}$	H $101\frac{3}{4}$ L $93\frac{5}{8}$	Private Joint Stock Co *Established* 1924 *Capital* $1,250,000 *Bonds issue* Equal to mortgages granted *Bonds issue* *Scope of business* Mortgage loans to industrial enterprises on security of real estate, ground, factory buildings, etc
II 6% £1,000,000, 1930–1955, issued at 95 Out £1,000,000		Semi-annual cumulative, by lot or purchase at par					H $94\frac{1}{2}$ L 87	
Municipal Mortgage Bank of Finland I $6\frac{1}{2}$% £1,200,000, 1927–1957, issued at 98 Out £1,000,000	First mortgages on house property (50%), further secured by additional mortgages which stand as security for the joint and several liability of the members, ranking equally on lien with the first mortgages, amounting to 10% of it (Each member is liable for the unpaid amount of his loan)	Semi-annual cumulative, by lot or purchase at par		H 98 L 96	H $101\frac{1}{16}$ L $95\frac{1}{4}$	H 101 L 96	H $98\frac{3}{4}$ L $93\frac{1}{2}$	Co operative Association *Established* 1927 *Capital* $5,000,000 Contributed by Government in 5% Government bonds *Bonds issue* Ten times capital plus reserve funds *Scope of business* Long term credits on urban house property, short term loans, the total amount of which may not exceed 10 per cent of the total liabilities
II 6% $10,000,000, 1928–1961, issued at $94\frac{1}{2}$ Out $10,000,000		As above			H $94\frac{3}{4}$ L 91	H 91 L 72	H 88 L $75\frac{3}{4}$	

FRANCE

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Crédit Foncier de France I 3% Frs 300,000,000, 1903–1978	First mortgages on agricultural or urban real estate (50%) for mortgage bonds Municipal loans for municipal bonds	Trimestrial by lot at par, or at par with a premium	H 250 L 215	H 305 L 240	H 369 L 300	H 384 L 320	H 425 L 385	Private Joint Stock Co *Established* 1852 *Capital* Frs 300,000,000 *Reserves* Frs 30,000,000 *Bonds issue* Fifty times the capital *Scope of business* Long term loans on urban and agricultural real estate, communal credits Short term loans under certain specified conditions Total of mortgage bonds outstanding in 1929, Frs 3,700,000,000 Total of communal bonds outstanding, Fr 6,100,000,000
II 3½% Frs 500,000,000, 1913–1983 Out Frs			H 249 L 210	H 315 L 235	H 375 L 300	H 394 L 331	H 440 L 387	
III 7% Frs 500,000,000, 1926–1976 Communal Bonds				H 492 L 450	H 540 L 475	H 540 L 513	H 597 L 562	
IV 5% Frs 500,000,000, 1929–1979 Out Frs 500,000,000 Mortgage Bonds						H 1,002 L 1,002	H 1,031 L 997	
V 4% Frs 600,000,000, 1930–1950								
VI 1½% Frs 2,200,000,000, 1930								

GERMANY

	Security	Sinking Fund	Price 1926	1927	1928	1929	1930	Note
Bavarian Mortgage and Exchange Bank I 6½% G M 15,000,000, 1927–1928, issued at £93 11s 10d per G M 2000 Registered certificates issued in respect of equal amount of 6½% mortgage bonds purchased by Guinness, Mahon & Co	First mortgages (60%) on urban and agricultural real estate Special reserve fund amounting to 5% of bonds in circulation Investment for trust funds	Semi annual, cumulative, at par by lot or purchase			H 95½ L 90⅞	H 94¾ L 89¼	H 92¾ L 85	Private Joint Stock Co *Established* 1884 *Capital* RM 15,000,000 *Reserves* RM 20,000,000 *Bonds issue* Fifteen times paid-up capital and reserve funds *Scope of business* Mortgage and general credit bank, the mortgage department run according to German Mortgage Bank Act Total of mortgage bonds outstanding in 1929, RM 546,380,000
II 6½% G M 6,000,000, 1927–1962 (Amsterdam)		As above		H 94¾ L 93	H 91⅞ L 90	H 85⅝ L 79¼	H 89 L 77	
III 7% G M 6,000,000, 1928–1963 Out G M 6,000,000 (Amsterdam)		As above			H 97 L 96⅝	H 95⅛ L 79	H 95¾ L 83¾	

GERMANY

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Preussische Central Bodenkredit A G I 7% G M 13,000,000, 1927–1967 Registered certificates of G M 1,000 and multiples issued by Rothschild & Sons, in respect of equal amounts of 7% mortgage bonds (London)	First mortgages (60%) on urban and rural real estate	Semi-annual, cumulative, by lot or purchase at par		100⅛				Private Joint Stock Co *Established* 1870 *Capital* RM 18,200,000 *Reserves* RM 8,000,000 *Bonds issue* Twenty times capital and reserve *Scope of business* Mortgage loans on urban and rural real estate, and credits to public bodies financed by communal bonds Total of mortgage bonds outstanding in 1929, RM 335,000,000, Communal bonds, RM 119,000,000
II 6½% G M 5,000,000, 1927–1970 Out G M 5,000,000 (Amsterdam)		As above			H 94 L 89⅞	H 90 L 79½	H 91 L 76	
III 7% G M 5,000,000, 1928–1960 Out G M 5,000,000 (Amsterdam)		As above			H 96⅜ L 92	H 96½ L 82	H 95⅛ L 85	

GERMANY

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Deutsche Rentenbank Kreditanstalt I 7% $25,000,000, 1925–1950, issued at 93 Out $23,000,000	First mortgages on agricultural property (40%) or cash No other bonds issued sharing in this specific security Each of the agricultural debtor organizations is individually liable with respect to amortized principal of their loans Special bond reserve of 5% for each of bond issues outstanding	Semi-annual cumulative, by lot or purchase at par	H 101¼ L 94	H 103⅜ L 97½	H 101¼ L 98	H 99 L 92	H 98½ L 81	State Bank *Established* 1925 *Capital* RM 500,000,000 Owned by Government Paid up, 400,000,000 *Bonds issue* Six times paid up capital, by special Reichsrat consent, eight times paid up capital *Scope of business* Credits to agricultural mortgage institutions and co operative associations specifically designated by law *Bonds out*, 1929, RM 360,000,000
II 6% $30,000,000, 1927–1960, issued at 95 Out $29,000,000		Semi-annual, cumulative, by lot or purchase at par		H 95¾ L 91½	H 93½ L 86¾	H 88¾ L 71	H 90⅝ L 65	
III 6% $50,000,000, 1927–1960, issued at 95½ Out $47,000,000		Semi-annual, cumulative, by lot or purchase at par		H 95¾ L 91	H 93½ L 86	H 88 L 70	H 90 L 66⅛	
IV 6% $30,000,000, 1928–1938, issued at 95½ Out $24,960,000		1½% p a semi-annual, cumulative, beginning Sept 5, 1928, by lot or purchase at par			H 96 L 88¾	H 91 L 86	H 94 L 78	
Saxon State Mortgage Institution I 7% $5,000,000, 1915–1945, issued at 93½ Out $4,000,000	First mortgages on industrial property (30%) Joint and several liability of the mortgagors up to 10% of the loan granted State guarantee	Semi-annual, cumulative, by purchase or lot at par	H 101 L 92	H 102½ L 97	H 99½ L 98	H 100½ L 87	H 100 L 78	State Bank *Established* 1925 *Capital* RM 1,000,000 Owned by Government *Bond issue* Limited to RM 75,000,000 *Scope of business* Mortgage loans on industrial and commercial real estate in Saxony
II 6½% $4,000,000, 1926–1946, issued at 97 Out $3,600,000		Semi-annual, cumulative, by lot or purchase at par	H 97½ L 97	H 101 L 93½	H 96½ L 93	H 95 L 83	H 97 L 74	
Bank of Silesian Landowners Association I 6% $6,000,000, 1927–1947, issued at 92½ Out $6,000,000	710 mortgage bonds of Association secured by first mortgages (30%) on agricultural property, unconditional charge upon property of all landowners affiliated Investment for trust funds	Semi-annual, cumulative, by lot or purchase at par			H 84½ L 80	H 85 L 69	H 85 L 72	Bank Department of Co op Association *Established* 1868 *Capital* RM 1,500,000 *Bonds issue* Equal to loans granted *Scope of business* Financial functions connected with credits on rural property to the members of the Association

GERMANY

CAPITAL, LOANS, AND BONDS OF THE GEMEINSCHAFTSGRUPPE IN GERMANY

In Millions of Marks	Latest Dividend	Capital before Fusion	Capital after Fusion	Reserves before Fusion	Reserves after Fusion	Loans: Mortgage	Loans: Communal	Loans: Total 31 12 29	Loans: Total 30 6 30	In Circulation: Mortgage Bonds 31 12 29	Mortgage Bonds 30 6 30	Liquidation mb 31 12 29	Liquidation mb 30 6 30	Communal Bonds 31 12 29	Communal Bonds 30 6 30	Total 30 12 29	Total 30 6 30
Preuss Centr.-Bodenkred u Pfandbriefbk	12	36	—	25 71	—	178 6	211 0	1,021	1,040	553 1	585 5	175 2	165 3	182 2	200 7	910 5	951 6
Deutsche Grundkreditbank Gotha	0	—	—	—	—	41 2	11 5	—	136 2	—	76 7	—	39 3	—	9 8	—	125 9
Preuss Bodenkredit Aktienbank	10	10 25	—	5 12	—	49 1	65 1	216	220 2	99 5	112 8	41 5	39 4	61 3	64 6	202 3	216 8
Schles Bodenkredit-Aktienbank	10	8 15	—	4 53	—	48 6	37 5	172 7	194 0	85 5	102 8	29 9	42 8	35 0	36 8	150 4	182 4
CENTRALBODENKREDIT A G	—	—	43	—	ca 37	317 5	325 2	—	1,591	—	877 8	—	286 8	—	312 0	—	1,477
Deutsche Hypothekenbank (Meiningen)	10	12 3	—	6 15	—	73 4	79 4	307 0	306 1	142 5	131 9	73 0	61 8	75 4	78 6	290 9	302 3
Norddeutsche Grundkreditbank	10	7 0	—	3 04	—	15 5	46 3	189 8	210 0	113 6	134 8	15 1	13 2	36 1	41 3	164 8	189 3
DEUTSCHE HYPOTHEKENBANK	—	—	14	—	14	88 9	125 7	—	516 1	—	296 7	—	75 0	—	119 9	—	491 6
Frankfurter Hypothekenbank	10	10 0	—	6 07	—	91 3	19 08	215 3	222 1	95 0	110 1	96 6	95 1	11 8	15 1	203 4	220 3
Frankfurter Pfandbriefbank	10	6 0	—	4 8	—	58 5	30 7	182 5	184 0	80 3	89 5	62 0	58 5	29 7	29 7	171 9	177 7
FRANKFURTER HYPOTHEKENBANK	—	—	12	—	12	149 8	49 8	—	406 2	—	199 7	—	153 6	—	41 7	—	398 0
Gemeinschaftsgruppe	12	60 2	85 5	62 8	ca 72 4	640 2	551 5	1,453	2,924	746 8	1,643	302 4	590	280 8	524 8	1,329	2,758
Percentage of all Private Mortgage Banks	—	—	—	—	—	41 2	73 8	—	46 1	—	42 1	—	39 9	—	73 7	—	45 3

GREECE

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
National Mortgage Bank of Greece I 7% £3,000,000, 1927–1957 issued at $93\frac{1}{2}$ Out £2,100,000	First mortgages on real estate (50%) or charges on property or revenues of public bodies Guaranteed by National Bank of Greece	Semi annual, cumulative, by lot at par		H $96\frac{1}{8}$ L $92\frac{1}{8}$	H 100 L $96\frac{1}{4}$	H $101\frac{1}{4}$ L $91\frac{1}{2}$	H $101\frac{5}{8}$ L 96	State Bank *Established* 1927 *Capital* Dr 81,000,000 Owned by National Bank of Greece *Bonds issue* Twenty-five times paid up capital *Scope of business* Mortgage loans on real estate and loans to public bodies

	granted and repaid in dollars Special reserve fund of 20% of bonds issue invested in dollar securities Investment for trust funds							50% owned by State, 21% by National Union of Manufacturers *Bonds issue* Equal to mortgages granted *Scope of business* Mortgage loans to industrial enterprises, secured not only by insurable assets but also by current assets

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ITALY

	Security	Sinking Fund	Price 1926	1927	1928	1929	1930	Note
Mortgage Bank of the Venetian Provinces I. 7% $5,000,000, 1927–1952 Out $4,400,000, Series A	First mortgages on urban and rural estate (50%) General liability of member banks as to their loans outstanding	Semi annual, cumulative, by lot at par			H 93½ L 90	H. 94 L 86	H 98 L 88	State Bank *Established* 1927 *Guarantee and Reserve Funds* $3,000,000 *Bonds issue.* Fifteen times fund *Scope of business* Mortgage loans on real estate, loans to public bodies Total of bonds outstanding in 1929 $30,400,000

NETHERLANDS

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Overijselsche Hypothekbank I 5½% Fl 6,000,000, 1920–1945, issued at par Out Fl 3,100,000	First mortgages on urban real estate (75%), bonds accepted by Rijks-verzekerungs bank	Annual, beginning immediately, by lot at par	H 100¼ L 100	H 100¼ L 100	H 100⅝ L 100	H 101½ L 101$\frac{1}{16}$	H 110⅝ L 100$\frac{1}{16}$	Private Joint Stock Co. *Established* 1902 *Capital* Fl 15,000,000 Paid up Fl 7,000,000 *Reserves* Fl 450,000 *Scope of business* Urban Mortgage credits Total of bonds outstanding in 1928 Fl 19,000,000
N V Rotterdamsche Hypothekbank I 6% Fl 2,500,000, 1921–1946 Out Fl 77,000	First mortgages on urban real estate (75%)	Semi-annual, by lot at par, beginning immediately	H 103 L 100¼	H 101 L 100⅜	H 101 L 100¾	H 101¼ L 100	H 103 L 101⅜	Private Joint Stock Co *Established* 1864 *Capital* Fl 10,000,000 Paid up Fl 6,000,000 *Reserves* Fl 700,000 *Scope of business* Mortgage loans on city real estate Total of bonds outstanding in 1928 Fl 56,000,000

NORWAY

	Security	Sinking Fund	Price 1926	1927	1928	1929	1930	Note
Royal Norwegian Mortgage Bank	First mortgages on rural property (60%) and on urban property (50%) Government guarantee Investment for trust funds							STATE BANK *Established* 1851 *Capital* Kr 57,000,000 In great part contributed by Government *Reserves* Kr 4,000,000 *Bonds issue* Eight times special reserve funds and capital *Scope of business* Mortgage loans on rural and urban property Total of bonds outstanding in 1928 Kr 400,000,000
I 3½% Kr 19,990,000, 1902–1962 (Paris)		Semi annual, by lot or purchase at par	H 2,350 L 1,445	H 1,775 L 1,685	H 1,800 L 1,725	H 1,800 L 1,740	H 1,860 L 1,790	
II 3½% Kr 10,000,000, 1905–1965 (Paris)		Semi annual, by lot or purchase at par	H 1,855 L 1,425	H 1,955 L 1,850	H 1,800 L 1,725	H 1,880 L 1,740	H 1,860 L 1,795	
Agricultural Properties Bank I £800,000, 1911–1921, issued at 99 Out £700,000	First mortgages on dwellings (60%), Government guarantee Investment for trust funds	Semi-annual, cumulative, by lot or purchase at par	H 75½ L 72	H 81 L 78¾	H 81⅝ L 77⅛	H 82½ L 78	H 87½ L 79	STATE BANK *Established* 1903 *Capital* Kr 5,000,000 Owned by Government *Bonds issue* Six times capital *Scope of business*, Mortgage credits on real estate
II 3½% Kr 14,990,000, 1904–1966 (Paris)		Semi annual, cumulative, by lot or purchase at par	H 2275 L 1540	H 1,750 L 1,720	H 1,785 L 1,695	H 1,765 L 1,685	H 1,860 L 1,780	

POLAND

	Security	Sinking Fund	Price					Note
			1926	1927	1928	1929	1930	
Land Mortgage Bank of Warsaw I 6% French Frs 50,000,000, 1929–1959 (Paris)	First mortgages, (50%) on rural property Joint and several liability of the mortgagors to the full value of their property Government guarantee	Semi annual cumulative, callable by lot at par				H 990 L 880	H 960 L 885	*Established* 1923 *Scope of business* Mortgage loans on agricultural real estate

SWEDEN

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
Royal Swedish Mortgage Bank I 4% Kr 14,400,000, 1879–1940 Out Kr 4,200,000 (Paris)	First mortgages on agricultural property (50%), joint liability of the Credit Associations and their members up to the amount of their loans outstanding	Semi-annual, cumulative, by lot at par		H 2,560 L 2,350	H 2,600 L 2,350	H 2,495 L 2,360	H 2,500 L 2,145	STATE BANK *Established* 1861 *Capital* Kr 30,000,000 Owned by Government *Scope of business* Mortgage loans to agricultural credit associations
II 4% Frs 13,600,000, 1909–1931 (Geneva)		Semi-annual, cumulative, by lot at par	H 490 L 477	H 491 L 488	H 500 L 480	H 490 L 474	H 494 L 485	
Town Mortgage Bank of the Kingdom of Sweden I 3½% Frs 210,000,000, 1910–1980 (Paris)	First mortgages on urban real estate (50%) joint liability of Town Associations	Annual, by lot or purchase at par	H 3,775 L 1,740	H 2,030 L 1,785	H 1,950 L 1,830	H 1,940 L 1,850	H 2,160 L 1,935	STATE BANK *Established* 1909 *Guarantee fund* Kr 50,000,000, paid in by Government *Bonds issue* Ten times guarantee and reserve funds *Scope of business* Mortgage credits to urban credit associations
Crédit Foncier de Stockholm I 4% Frs 80,000,000, 1903/12–1979 (Paris)	First mortgages on Stockholm real estate (50%)	Annual, by lot at par	H 4,070 L 2,040	H 2,260 L 2,030	H 2,245 L 2,095	H 2,220 L 2,125	H 2,315 L 2,190	Private Joint Stock Co *Established* 1869 *Capital* Kr 20,000,000 *Reserves* Kr 14,000,000 *Scope of business* Mortgage loans on urban real estate in Stockholm

YUGOSLAVIA

	Security	Sinking Fund	Price 1926	Price 1927	Price 1928	Price 1929	Price 1930	Note
State Mortgage Bank of Yugoslavia I 7% $12,000,000, 1927–1957, issued at 92 Out $11,000,000	First mortgages on real estate or revenue pledged by public bodies	Semi annual, cumulative, beginning Apr 1, 1928, at par plus interest, callable by purchase or lot		H 92½ L 82	H 90 L 80	H 81½ L 68½	H 86 L 74	STATE BANK *Established* 1862 *Capital* $10,000,000 *Reserves* $440,000 *Bonds issue*, equal to loans granted *Scope of business* Mortgage loans on real estate and loans to public bodies Total of foreign bonds issued in 1929 $17,300,000
II 7% Frs 12,300,000, 1924–1936, issued at 94% Out Frs 9,000,000 (Basel)			H 95 25 L 94	H 99 75 L 94 15	H 98 L 94 50	H 95 50 L 92	H 98 50 L 95	
III 7% Frs 10,000,000, 1927–1937, issued at 96% Out Frs 8,000,000 (Basel)				H 95 50 L 93	H 97 15 L 94 50	H 94 25 L 90 75	H 97 L 92	
IV 4½% Frs 30,000,000, 1910–1960 (Paris)		Semi-annual cumulative, beginning 1911, by lot or purchase at par	H 540 L 346	H 530 L 353	H 615 L 510	H 574 L 481	H 684 L 510	

UNITED STATES OF AMERICA

	Security	Sinking Fund	Price					Note
			1926	1927	1928	1929	1930	
Mortgage Bond Co, of New York I 4% $5,000,000, 1909–1966, issued at 90 Out $3,000,000	First mortgages on urban real estate (50% in cities with a population up to 300,000, ⅜ in cities over 300,000, ⅛ in New York) Mortgages deposited with Trustee	Semi annual, beginning Apr 1, 1912, by lot at par	H 81 L 81	H 83 L 83	H 82½ L 82			Private Joint Stock Co *Established* 1905 *Capital* $2,000,000 *Bonds issue* Fifteen times paid up capital *Scope of business* Mortgage loans on improved city real estate in towns with not less than 40,000 population Total of bonds outstanding in 1929 $26,900,000
II 5½% $2,100,000 1927–1937, issued at par Out $2,100,000		Semi annual, by lot at par		H 101½ L 98	H 101 L 97			

UNITED STATES OF AMERICA

	Security	Price					Note
		1926	1927	1928	1929	1930	
Federal Land Banks I 4½% $202,600,000, 1922–1942, issued at par Out $200,000,000	First mortgages on agricultural real estate (50%) guaranteed by the local National Farm Associations of which the borrower is a stockholder Each stockholder is liable for two times his stock All Federal Land Banks are jointly liable for the bonds issued Investment for trustee and public funds under the control of the Federal Government and in many States				H 94 L 90	98¾ [1]	*Established* 1917 *Capital* $66,100,000 *Reserves* $32,000,000 *Bonds issue* Equal to mortgages granted *Scope of business* Agricultural mortgage loans Total of bonds outstanding in 1930, $6,186,700,000
II 4½% $76,500,000, 1925–1955 Out $75,000,000					H 94 L 90	98½ [1]	
III 4½% $75,000,000, 1926–1956, issued at 101 Out $67,000,000					H 94 L 90	95¼ [1]	
IV 4% $28,000,000, 1927–1957, issued at par Out $26,000,000					H 90 L 87	92¼ [1]	

[1] Price quoted on 15th May, 1930

APPENDIX II

ALTERNATIVE MACHINERY TO THE INTERNATIONAL MORTGAGE BANK

THE development of an international market for mortgage bonds has already influenced the structure of mortgage banking in a number of countries as well as the nature of the bonds issued. But the question arises: Are further measures to increase their marketability possible? We have considered in Chapter VIII the advantages which would accrue from the establishment of an international mortgage bank. Other proposals also require examination: (1) the development of a specialized underwriting syndicate, (2) the development of a guarantee association to insure the payment of dividends and redemption of bonds, (3) the formation of an investment trust issuing its own script against bonds purchased. Let us examine these seriatim.

1. A specialized underwriting syndicate must consist in practice of a few representatives of the existing issuing houses. Clearly, new houses must take many years to achieve a reputation and a following. Borrowing banks would, in fact, go to the older houses with whom they already have business relations. Indeed, it is doubtful whether any new group could establish itself against the competition of the existing firms, and, even if they could, whether there would be enough business for them. This suggestion has, therefore, no practical value.

2. America has shown how a guarantee association works. Nor can it be denied that large financial houses, such as insurance companies, could very usefully guarantee the dividends and capital of mortgage banks within their country. But it is a much bigger undertaking to attempt to establish an international association which would be ready at a certain price to guarantee the bonds of mortgage banks in any country

It would require a widespread machine for investigating the mortgages offered and for supervising them Perhaps the greatest difficulty would result from the requirement that such an association should have very great resources if it is to inspire the necessary confidence But, technically, such an association would be possible if it took the necessary safeguards and could render a very valuable economic service

3 More significant practically, and the only alternative to the international mortgage bank, is the proposal of an international investment trust It would be a comparatively simple matter to establish a trust which held nothing but mortgage bonds Nor would it be anything like as risky as an investment trust which confines itself to securities in companies concerned in the production of one product Geographical distribution of risk would be possible, holdings could be divided into rural, urban, and industrial bonds, communal bonds, Government guaranteed bonds, as well as bonds secured by private property, could be held Indeed, it is highly likely that such a trust with the specialized knowledge which would result from restricting itself to one class of securities, would have a distribution of risk at least as good as that of the average investment trust which is not restricted Certainly it could enjoy all the advantages which the Foreign Railways Investment Trust enjoys—high yielding securities well distributed In addition, it is submitted, it would enjoy a safer type of security, which is undervalued at the present time

One drawback which it has compared with the international mortgage bank is that it could not obtain such large amounts of capital with such ease A trust must rely to a much larger extent on its own capital

APPENDIX III

FOREIGN EXCHANGE INSURANCE

THE question has been raised whether it is possible to organize insurance against one, and only one, of the dangers of foreign investment—that of monetary *malaise*—of the risk of inflation

This is, indeed, part of a larger question of insuring against all risks The chairman of Barclays Bank, Mr Goodenough, proposed to establish fixed rates of exchange within the British Empire, and was supported by Professor H G. Foxwell.[1] We, too, shall limit ourselves to the form of the problem of insuring against exchange fluctuations

Even if annual payments are set aside by investors in foreign securities to form a sinking fund for meeting default resulting from inflation, there can be no guarantee that they will accumulate sufficient to cover their capital before the undesired event occurs Besides, in so far as the individual investor wishes to leave behind him certain sums for his heirs, he is not sure he will live long enough for these annual instalments to accumulate to the sums invested

There are many methods of insuring investment risks The discount and acceptance houses give their endorsement or guarantee that certain bills will be met Underwriting in its purest form is a strict insurance of sale In return for a certain sum of money, usually 1 to 5 per cent, the underwriters agree to buy all securities unsold by a certain date up to the amount for which they have underwritten An average of something over 1 per cent is usual on the issues of foreign and colonial governments with ¼ per cent over-riding commission to brokers for placing the underwriting Industrial companies paying 5 per cent are paying ½ per cent to the nominal rate of interest for twenty years The joint-stock banks have

[1] A letter in the Bankers Magazine dated 15th Feb 1918

occasionally given their guarantee to the security of individual borrowings of companies from their rather personal acquaintances, and so have saved the company from the necessity of making an issue of securities which would inform the public that the company was borrowing Certain insurance companies will also provide credit insurance facilities up to a certain portion of foreign claims These are all devices for insuring short term risks The purchase of forward exchange is a device for obtaining insurance against inflation alone for a short period

What machinery is there for the insurance of long time risks? There are two such devices and both are to be found in connection with mortgage banking The first is the simple device of substituting the name of a well-known big firm for that of an unknown small one, and the second is that of guaranteeing payment if the contracting firm does not fulfil its obligations In the former case the mortgage banker issues bonds to raise money with which to buy individual farm or urban or industrial mortgages It substitutes for the security of the unknown borrower its own well-known and readily marketable security The second device is that of the surety companies which guarantee the reliability of real estate mortgage bonds issued by certain companies A policy of insurance is sold to cover the payment of principle and interest of certain specific mortgage bonds As we have noted in the United States, one-half of 1 per cent is frequently charged as a premium for this service But the task of insuring certain types of securities in the currency of the country in which they are issued by insurance companies situated in them, whilst pointing to a method of tackling the problem of insuring foreign exchange, is still in its infancy, and more experience of its working in other countries would be desirable

No machinery exists for insuring the payment of long term loans or of interest on them in a stable currency. The consequence is that as soon as there is a likelihood of inflation in any country, its export and import trade become demoralized and its ability to obtain credit is greatly reduced or cut off.

This aggravates its economic position still more and a vicious circle sets in

The question arises, is it possible to make available currency insurance? The immediate reply will be that in the absence of strict actuarial guidance it will be impossible to design the machinery to cover the chances of such a calamity But here as elsewhere with respect to the burden of risk bearing, the question really is whether it is to be borne in an unorganized or in an organized way, and not whether it is to be borne at all Of course, a complete stoppage of foreign loans is another possibility. But this produces such dangers that in practice it is found to be desirable to avoid them If loans are to be granted, they will carry a risk with them In spite then of the undoubted difficulties in perfecting the machinery for guaranteeing currencies of different countries, the question remains whether some large scale organization can be devised which, with a scientific staff, considerable resources and growing experience can save us from some of the numbing effects of inflation An analysis and interpretation of the experience of recent years would, no doubt, suggest a policy wiser than that pursued quite blindly by the average investor Short of some special new mechanism a number of devices are available Loans are frequently made nowadays on condition that the borrower repays in gold of a given fineness or in pound sterling or in gold dollars, or in, say, any one of three currencies at the option of the payee Another condition is the assignment of some specific revenue to the service of the debt

A great variety of guarantees has been provided for different loans In the States that needed salvaging after the war nations were prepared to consent to the League of Nations stepping in to organize their finances Before the war a financial consortium was sometimes appointed by a number of Powers as a condition of granting loans But it is clear that these devices are not by themselves adequate for the purpose, since in spite of them loans are not being granted on a sufficiently large scale Is it then possible to organize some form of international currency institute?

In order that a given risk shall be insurable it must satisfy four conditions—

1 There must be a clearly specified risk,

2 Large numbers must be subject to it,

3 It must be capable of being calculated with some degree of certainty,

4 The risk must constitute a menace against which those subject to it desire to provide

The risk of credit inflation can be formulated in a manner which leaves little doubt If, say, an Englishman who invests in a foreign country finds that twenty units of its currency normally change for one pound sterling, but that on a given date they are exchanging for 5s, then he has an exact measure of his loss Clearly, all who invest abroad are subject to this risk, and most of them would be glad to insure against it None carry avoidable risks if they can insure against them at a reasonable rate It must, however, be conceded that the risk cannot be calculated with certainty

Could not a few of the leading insurance companies of the world organize a guarantee of 50 to 75 per cent of the interest and capital of certain definite loans The task which the insurance companies are asked to undertake are then, first, to guarantee payment of interest on mortgage bonds and their ultimate redemption, and, secondly, to guarantee them in stable currency The insurance rates would vary according to the standing of the countries Some might be regarded as suspect for a number of years like the Balkan countries, some will be like Spain, Argentine, or Brazil, which are to-day off the Gold standard, whilst others, like Australia, might seem uncertain The economic circumstances of each State can be investigated to discover what chances there are of its going off the gold standard With this as a basis a schedule of rates could be drawn for insuring the risk It is, however, likely that because of inadequate information insurance rates for the first decades would be relatively high The following questions can be answered for every country—

1 Has the country a record of sound currency?

2 Is its economic life comparatively stable?

3 Is it a country of healthy economic expansion?

4 Has it a favourable balance of international payments?

5 Is the budget balanced, and is there proper provision for debt redemption?

6 Are the charges on unproductive debt very high?

7 Are its loans used productively?

The practical limitations are that it would be necessary to carry insurance for a considerable number of countries, and that only an arrangement made by the leading insurance companies would guarantee the exchange of certain securities Otherwise, there would be insufficient capital with which to carry on the business and to assure the large hazards

It is not unlikely that there would be a concentration of the risks of the countries where credit was weak But this fact does not prevent some distribution of risk After all, it is as possible to organize fire insurance for asbestos as for steel mills The premium charged is higher There would also be a practical cancelling out of relatively good and relatively bad risks Let us take one example to illustrate this from the recent history of one of the countries which inflated, viz France Loans which would have been insured at a rate below 125 francs to the pound sterling would, perhaps, have involved a loss, loans insured to guarantee above that rate would, perhaps, have carried a profit But it should not be forgotten that when *de facto* stability was reached at 125, and soon later when legal stability was established for a time at any rate, people felt uncertain that it would be maintained, and therefore would have been ready to avail themselves of insurance facilities This business would very likely have been profitable to the guarantee company

Such a company has a further device not available to the individual investor It can place the funds it obtains for the guarantee of any country in that country It could purchase and own property there Such property will not necessarily decline in value to the extent of its foreign currency Moreover,

when the period of monetary *malaise* has passed its value may, and indeed is likely to, resume its old value in terms of gold

Of course, this company will have to choose between the various loans which are offered to it for its guarantee It would thus be in a position to lay down its conditions to the borrowing organization and to the investors It would choose only those in which it was satisfied with the security, the redemption arrangements, the provision for currency stability made by the lender, and would have to claim the rights of the investor to repayment after default has occurred They might even advise Governments who would be ready for advice for they resort, as a rule, to the most onerous expedients before repudiating their external obligations

One serious argument against providing such a guarantee is that it would slacken the pressure on governments in distress, so that they would more readily adopt a policy of inflation Citizens organize themselves into foreign creditors' associations, and bring pressure to bear on their governments to intervene with the defaulting country But these measures have not always been successful And the most potent argument of all, the fear of no fresh loan, has not always been available Those who have defaulted towards their creditors in one country have occasionally found little difficulty in raising loans in another

An international currency guarantee company with insurance companies in all the creditor countries participating in it is more likely to be able to be more effective along these lines It will make it more difficult for the defaulter to borrow again until just claims were disposed of, refusing to guarantee any new loans that it might succeed in raising

Insurance companies are already concerned in the problem of the depreciation of overseas' currencies The premium incomes received in such currencies and their investments in them constitute a problem which must be faced A reluctance to grant British and American cover to countries where the native insurance companies have suffered setbacks is not facing the real difficulties in a constructive spirit.

It might seem that international mortgage banks by diversifying their list of securities will provide all the insurance that is necessary We have noted that diversification can be attempted geographically, between different industries, agricultural, urban, and industrial, between different companies or governments in each of these; and between mortgage and communal bonds Losses in certain securities which defaulted would consume only a relatively small portion of the total assets at a time Nor can it be denied that if such banks had very large resources the need for currency insurance would be less But it is precisely because of these currency risks that they will be obliged to pursue a very cautious and restricted policy

A simpler way of dealing with the immediate crisis would be to raise a large loan guaranteed by the central banking authorities of England, the U S A and France

APPENDIX IV

Length of Agricultural Credits

Recent changes in agricultural production have called attention to the appropriate lengths of agricultural loans Small independent working cultivators have in the past required three types of credits Short loans were necessary to finance the preparation and movement of crops Intermediate credits, i e relatively long term personal and collateral credits for periods of six months to three years, were desirable to furnish the cultivator with the capital for purchasing implements and live stock, and making small improvements to his holding Long credits were required to provide the capital for the purchase and development of land

Complementary to these types of credit were the arrangements for supplying seed and manure on credit, for making special advances against specified crops, securing the cultivator against the need of selling his produce at a time when the market was overloaded with offers, and the loans to co-operative societies

Certain short term credit requirements of farmers are similar to those of manufacturing and merchandising concerns, and can be liquidated in three to six months But the business of farming with one turnover per year makes longer loans necessary than those made available by the commercial banks A series of special institutions was called into existence to provide these facilities The first comprehensive system was established in the United States under the Agricultural Credits Act of 1923 Twelve Federal intermediate credit banks were founded in the twelve Federal land bank districts, with headquarters in the same place as the land bank They were established with a capital stock of $5,000,000 —which was to be subscribed by the Secretary of the Treasury

and operated under the general supervision of the Federal Farm Loan Board On the bases of their general assets and their joint liability, they issue three- to five-year collateral trust debentures These banks make loans and offer rediscount facilities for periods ranging between six months and three years to co-operative marketing associations, agricultural credit corporations, live stock loan companies, State and national banks, but are not authorized to deal directly with individuals In practice, the longer loans are granted for twelve months, and are then renewed They require, as a rule, mobile assets as security They rediscount (1) agricultural notes endorsed by a bank or some other agricultural credit corporation, (2) notes on live stock endorsed by cattle companies, and (3) notes issued by co-operative marketing organizations The loans are used in part as working capital, in financing the annual crops, and in part as investment capital spent on fertilizers, cattle, fruit trees, etc

The success of the American system of intermediate credits, coupled with the scarcity of credit facilities, has stimulated the desire for the establishment of similar machinery in the agricultural countries of Europe The Warsaw Conference of Central and East European Powers, in 1930, recommended the desirability of raising three- to five-year bonds in the foreign capital markets But, besides mobile assets as security, they proposed that second mortgages on real estate should be utilized This was because only a small percentage of the value of property can now be borrowed on first mortgage, and they urged that it should be possible to raise funds on second mortgage, provided that together with the first they did not exceed 50 per cent of the appraised value, and because they lacked the sound organization of American grading and storing which gives other types of security the qualities necessary for marketability There is little expectation, however, that foreign capital can be raised for these purposes, so that they will have to rely on their Governments or on their own capital markets

The full incidence of the industrial revolution is now being

increasingly felt in agriculture, and this is likely to produce far-reaching changes in the type of credit and in the machinery for providing it Time will justify or falsify the prophecy that the old type of peasant and farm-worker are to disappear altogether with the institution they represented Nor need we speculate whether the general mechanization of agriculture is to follow the same lines as the mechanization of industry, nor whether the mobile petrol engine, "small, durable, efficient, and easy to manage," together with the combine, are to do for agriculture what Watt's steam-engine did for industry It is evident that agriculture is no longer to remain the unchanging or slow-changing industry it was until the war

Under those conditions the borrower planned to repay the principal of the long period loan out of the accumulated earnings of the farm or the rentals of the urban property But under the new circumstances, fifty- and sixty-year loans are less easy to obtain

Special arrangements have sometimes been made to enable borrowers to repay debts sooner These have proved very satisfactory The mortgage debt of Egypt was reduced considerably during the past ten years, as is evident from the figures of the Crédit Foncier Egyptien, which fell from £27 million in 1914 to £17 million in 1929 This was attributed to the large profits made from the cultivation of cotton and to the dearth of land fit for reclamation There was both an increased supply of funds and a decreased demand for long term credit In Great Britain the Agricultural Mortgage Corporation also facilitates quick repayment of loans But this does not seem to meet the new circumstances It is desirable that the mortgagor of property shall be able to repay his loans as soon as it is convenient to him The question remains, however, shall he be given the right to repay for fifty or sixty years

Short and intermediate credits are necessary to prevent produce being forced on to the market at certain periods at an unduly low level, whilst, as we have seen, longer credits

are indispensable to rationalize the productive and the marketing processes But, whatever the period decided upon for intermediate credits or long period credits, their function should be scrupulously observed They should not be used to delay prices reaching their proper level Such a policy would result in considerable losses

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